Supreme Court, U.S.
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No. 93-

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

LASZLO N. TAUBER, M.D.,
Petitioner,

v.

SALOMON FOREX, INC., SALOMON INC.,
SALOMON BROTHERS, INC., and FRED GATLING,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Treasury Amendment to the Commodity Exchange Act, 7 U.S.C. § 2(ii), permits a firm in the business of dealing in futures and options to avoid regulation under the Act by choosing to conduct such dealing outside a regulated exchange.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Laszlo Tauber seeks review of the judgment of the United States Court of Appeals for the Fourth Circuit in this case. The court of appeals held that the "Treasury Amendment" to the Commodity Exchange Act (CEA), 7 U.S.C. § 2(ii), excludes from the comprehensive CEA regulatory scheme, and hence from the jurisdiction of the Commodity Futures Trading Commission (CFTC), a broad class of trading in options and futures involving foreign currency, government securities (such as Treasury bonds), and various other instruments, at the discretion of the trading parties. Petitioner challenges that interpretation of the CEA, which conflicts with other circuits' decisions and improperly permits a staggering volume of options and futures trading to avoid compliance with the CEA.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-26a) is reported at 8 F.3d 966. The opinion of the district court (Pet. App. 27a-44a) is reported at 795 F. Supp. 768.

JURISDICTION

The judgment of the court of appeals was entered on October 18, 1993. Pet. App. 2a. A timely petition for rehearing was denied on November 17, 1993. Pet. App. 55a-56a.

STATUTE INVOLVED

The Treasury Amendment to the CEA, 7 U.S.C. § 2(ii) [Section 2(a)(1)(A)(ii) of the CEA], states:

> Nothing in [the CEA] shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

This and certain other pertinent portions of the Commodity Exchange Act are reprinted at Pet. App. 57a-72a.

STATEMENT

This case involves trading in options and futures contracts. Although the contracts have an underlying commodity as their subject matter (here, foreign currency), entry into neither type of contract itself effects or is intended to effect a transfer of the commodity. Indeed, an option confers on one party only a right to make a future sale (never to be exercised if prices change adversely), and even futures, which on their face impose mutual obligations to make a future sale, are legally characterized by the parties' lack of intent actually to do so. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 358 (1982) (futures trading is done "with

no intent to take delivery"). Rather, trading parties buy and sell the contracts themselves, entering into "offsetting" transactions to net out gains or losses in cash. Nevertheless, the courts below, in their principal ruling, held that the purchase and sale of both options and futures constitute "transactions *in*" the underlying commodity under the Treasury Amendment (7 U.S.C. § 2(ii)) and, therefore, are wholly excluded from federal regulation under the CEA if the trading parties choose to exempt themselves from the regulatory regime.

A. Statutory Framework

The Commodity Exchange Act, 7 U.S.C. § 1 *et seq.*, is the comprehensive federal scheme regulating transactions relating to "commodities." Though originally limited to a list of named agricultural products, the statute was vastly expanded in scope in 1974, when Congress created the CFTC and extended the definition of "commodity" to include "all other goods and articles, . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. § 1a(3). The statute declares that the CFTC "shall have exclusive jurisdiction" over options and futures transactions, "except to the extent otherwise provided in section 2a of this title." 7 U.S.C. § 2(i).[1] The Act then imposes a host of regulatory restrictions on various forms of commercial activity involving a commodity (as long as it is the subject of trading in "contracts for future delivery," *i.e.*, "futures"), including rules relating to transactions in futures, options, and the commodity itself.

As to futures (contracts imposing mutual obligations to conduct a sale in the future), the fundamental requirement is that trading in the contract must take place on a formally organized exchange designated by the CFTC. 7 U.S.C. § 6(a). *See Merrill Lynch,* 456 U.S. at 359 ("futures trading must be regulated by an organized ex-

[1] The provision referred to in the except clause relates to certain securities-related transactions reserved to regulation by the SEC (7 U.S.C. § 2a). That provision is not at issue here.

change"). Any CFTC-approved exchange must, in turn, meet a host of detailed requirements. *See, e.g.*, 7 U.S.C. §§ 7, 7a. The specific rules that govern exchanges, together with the basic command that all futures trading take place on an approved exchange, are designed not only to protect traders (*e.g.*, against fraud, price manipulation, and insufficient collateral) but also to preserve properly functioning markets in the futures as well as in the underlying commodities (*e.g.*, by ensuring liquidity and open dissemination of trading prices). *See* Stein, *The Exchange-Trading Requirement of the Commodity Exchange Act*, 41 Vand. L. Rev. 473, 482-85 (1988).[2]

The CEA also extensively regulates trading in options (contracts that give one party a right, but not an obligation, to engage in a future sale with the other party). Although the regulatory regime is separate and in some respects different from that governing futures (*compare* 7 U.S.C. § 6c (options) *with* 7 U.S.C. § 6 (futures)), the basic requirement of trading on an approved exchange is the same. Thus, the statute provides that trading in options is allowed only to the extent permitted by the CFTC. 7 U.S.C. § 6c(b). And, as relevant here, the CFTC has banned the offer and sale of commodity options when not conducted on a CFTC-designated exchange. 17 C.F.R. § 32.11.[3]

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[2] In 1992, Congress gave the CFTC new authority to craft exemptions from the basic exchange-trading requirement, and other requirements applicable to futures, for particular types of transactions. 7 U.S.C. § 6(c). That authority has not been exercised to exempt the particular transactions or types of transactions involved in this case.

[3] The CEA excludes from its coverage options on foreign currency when traded on a national securities exchange. 7 U.S.C. § 6c(f). That provision does not apply to the off-exchange trading at issue in this case—although its enactment in 1983, as explained below, is relevant to the legal analysis in the case. In addition, some off-exchange dealing in "trade options"—options transactions "solely for purposes related to" a business's use of the underlying

In addition to futures and options, the CEA contains various provisions applicable to "commercial *cash* or *spot* market transactions in commodities" (1 P. Johnson & T. Hazen, *Commodities Regulation* § 1, at 2 (2d ed. 1989))—that is, purchases and sales, with actual delivery, of the commodity itself. Although such transactions need not be conducted on a regulated exchange, the CEA imposes a number of prohibitions—*e.g.*, or cornering, price manipulation, and false market reporting—that directly apply to such cash-market transactions. 7 U.S.C. §§ 7, 9, 13. *See also* 7 U.S.C. § 6i (reporting requirement for cash transactions).[4] Those provisions apply not only to sales where delivery is immediate, but also to sales where delivery, though fully intended, is deferred. Such "cash forwards" are specifically distinguished from "futures" under the CEA, although they are both contracts providing on their face for "future delivery" in an ordinary sense: the CEA expressly *defines* "future delivery" (the term describing "futures") to exclude "any sale of any cash commodity for deferred shipment or delivery" (7 U.S.C. § 1a(11)), thus establishing as a defining characteristic of futures the absence of a contemplated transfer of the underlying commodity.[5] Cash for-

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commodity—is permitted. 17 C.F.R. § 32.4(a); *see also* 7 U.S.C. § 6c(d). As this case comes to the Court, that authorization is not applicable here. *See* note 6, *infra*.

[4] *See SEC-CFTC Jurisdictional Correspondence*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,117, at 20,831-41 (Letter from CFTC's Office of General Counsel, on behalf of CFTC, to SEC, Dec. 3, 1975) (CFTC's first discussion of Treasury Amendment, pointing to provisions of the CEA applicable to cash transactions).

[5] *See Merrill Lynch v. Curran*, 456 U.S. at 358 (futures trading is done "with no intent to take delivery"); *CFTC v. Co Petro Mktg. Group, Inc.*, 680 F.2d 573, 578, 581 (9th Cir. 1982); 1 P. Johnson & T. Hazen, *supra*, § 1.05, at 14-18; CFTC, *OTC Derivative Markets and Their Regulation* 145 (Oct. 1993) (*"1993 CFTC Report"*); *Statutory Interpretation Concerning Forward Transactions*, 55 Fed. Reg. 39,188, 39,191 (1990) ("delivery as the feature distinguishing"

wards are accordingly excluded from the CEA provisions governing futures but remain subject to the CEA provisions governing cash transactions.

Among the commodities covered by the CEA is foreign currency, because there has long been trading in foreign-currency futures, as the 1974 Congress itself recognized. *See* S. Rep. 1131, 93d Cong., 2d Sess. 19 (1974); H.R. Rep. 975, 93d Cong., 2d Sess. 41, 153-54 (1974). Under the foregoing provisions of the CEA, therefore, any trading of options and futures involving foreign currency outside a regulated exchange ("off-exchange" trading) is prohibited. The legal issue presented in this case is whether violations of those prohibitions are excused by the "Treasury Amendment" to the CEA, which in relevant part states: "Nothing in [the CEA] shall be deemed to govern or in any way be applicable to transactions in foreign currency, . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii).[6]

B. This Dispute

Respondents (collectively, Salomon) are in the business of dealing in foreign currency options and futures, as well as numerous other financial instruments (such as government securities). In early 1989, Salomon's foreign currency affiliate (Salomon Forex)—an entity whose trading has never been subjected to regulation by federal banking authorities or other federal agencies other than the CFTC—began extensive trading of foreign currency options and futures contracts with petitioner Tauber per-

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forwards from futures). *See 1993 CFTC Report* 144 ("a particular contract may not be deemed to be both a futures contract and a cash forward contract under the CEA").

[6] That is the issue presented because the case was resolved by both the court of appeals and the district court on the assumption that it involves neither "trade options" nor "cash forwards." *See* Pet. App. 32a n.8 (district court); Pet. App. 17a, 22a (court of appeals).

sonally.[7] In that trading, Salomon acted as a dealer, not broker: it took the opposite side of its transactions with Tauber.

This trading was not for the purpose of acquiring currency. With only four exceptions, none of the 1,260 futures or 1,442 options resulted in delivery; rather, exposure on one set of contracts was "offset" by entry into other contracts, resulting in net dollar profits or losses. *See* Pet. App. 4a, 7a, 30a-31a. All of the trading occurred off-exchange, without any of the financial protections for both parties required by the regulated exchanges, including the requirement of daily calculation and posting of appropriate collateral (based on complex formulas for evaluating outstanding exposures). *See* S. Rep. 22, 102d Cong., 2d Sess. 3-4 (1992) (discussing practice of daily "marking to market"); 1 P. Johnson & T. Hazen, *supra*, § 1.10, at 41-48.

In October 1989, Salomon informed Tauber that it had miscalculated the proper collateral by $25 million: whereas Salomon had told Tauber that he had a $15 million surplus, in fact Tauber was $10 million short. Pet. App. 24a. Trading nevertheless continued until March 1991. At that point, Tauber had 68 futures contracts outstanding, due to mature in July and August 1991. Upon maturity, "[j]ust over $25 million became due and payable" to Salomon under those contracts. Pet. App. 4a.

In September 1991, Salomon sued for damages for breach of the 68 futures contracts, invoking the diversity jurisdiction of the United States District Court for the Eastern District of Virginia. As relevant here, Tauber answered that the contracts were unenforceable because they had been entered into off-exchange, in violation of the CEA. In addition, Tauber filed a counterclaim for

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[7] The district court found that Tauber "was Salomon Forex's only non-institutional client during this period." Pet. App. 30a.

damages from the sale of options (also illegally conducted off-exchange), which are subject to a stringent remedy under the CEA: "[a]ny person . . . who violates [the CEA] . . . shall be liable for actual damages . . . caused by such violation to any other person . . . who purchased from or sold to such person . . . an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade)." 7 U.S.C. § 25(a)(1)(C)(i). Accordingly, the legality under the CEA of both the off-exchange futures trading and the off-exchange options trading was squarely placed in issue.

C. The District Court Decision

The district court granted summary judgment in favor of Salomon, holding that the Treasury Amendment removed trading in both futures and options involving foreign currency (and government securities and the other instruments listed in the Amendment) from the coverage of the CEA. Pet. App. 27a-48a, 51a-54a. The court concluded that compliance with the CEA was entirely optional with traders, depending on whether they chose to trade on or off exchange: "if folks want to deal off exchange trading in currencies, the Commodities Exchange Act does not apply. It doesn't matter whether it's an individual or an institution or what the nature of the entity is." Pet. App. 54a.

At the outset of its analysis of the Treasury Amendment, the court concluded that the "unless" clause of the Amendment did not apply here because none of the trading in this case "was conducted on a board of trade," a conclusion evidently based on reading "board of trade," despite its statutory definition (7 U.S.C. § 1a(1)), to refer only to organized exchanges. Pet. App. 35a. As a textual matter, then, the court said, "the disputed contracts are exempt from the CEA if they constitute 'transactions in foreign currency.'" Pet. App. 36a. On that question, the court ruled that "the phrase 'transactions in

foreign currency' plainly and unambiguously means any transaction, without limitation as to the participants involved, in which foreign currency is the commodity or subject matter." Pet. App. 37a.[8] "All transactions in which foreign currency is the actual subject matter of an off-exchange contract for future delivery are exempt from the CEA." Pet. App. 42a-43a.

D. The Court of Appeals Decision

The court of appeals affirmed. Pet. App. 1a-26a. The court began with a discussion of the legislative history leading to the enactment of the Treasury Amendment as part of the 1974 expansion of the CEA. Pet. App. 4a-10a. The court then described the varying interpretations of the Amendment put forth in the numerous briefs, including separate *amicus* filings (taking different positions) by the CFTC and by the United States, as well as filings by two state regulatory authorities and by a host of industry participants. Pet. App. 11a-14a. The court noted that the CFTC's contemporaneous interpretation of the 1974 Treasury Amendment (*see SEC-CFTC Jurisdictional Correspondence*, *supra*) adopted the view we urge —that the Amendment applies only to cash-market transactions in the actual *commodity*, not to transactions in *contracts*, whose subject matter may be the commodity but which, like futures and options contracts, are not intended to produce a transfer of the underlying commodity. Pet. App. 12a. The court of appeals nevertheless rejected that interpretation.

The court first reasoned that the "transactions in" clause of the Amendment must cover futures because the "unless" clause removes futures from the Amendment's reach. Pet. App. 15a-16a. The court next stated that

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[8] With respect to options in particular, the court acknowledged, without rejecting, the argument that the purchase or sale of an option is not a "transaction[] *in* foreign currency," but it held that the Treasury Amendment applies "once the option is exercised and the foreign currency traded or exchanged." Pet. App. 41a.

the Amendment had to reach beyond cash transactions, including cash forwards, in order to avoid redundancy, because cash forwards were already excluded from the CEA. Pet. App. 16a. Then, while apparently agreeing that the phrase "transactions in foreign currency" might not include "transactions *in contracts* for foreign currency," the court rejected the distinction for purposes of the CEA, because cash forwards were concededly included among "transactions in foreign currency." Pet. App. 16a-17a. Finally, citing 7 U.S.C. § 5, the court asserted that "the language of the Treasury Amendment excluding 'transactions in' the subject goods is used elsewhere in the Act to mean all transactions *involving* the commodity." Pet. App. 17a. Based on those textual arguments, the court inferred that futures must be covered by the Treasury Amendment and added: "it is a short step to conclude that the Treasury Amendment applies to *all* transactions in which foreign currencies are the subject matter, including options." Pet. App. 17a. The Fourth Circuit broadly concluded, as the district court had done: "under the appropriate interpretation of the Treasury Amendment, all off-exchange transactions in foreign currency, including futures and options, are exempted from regulation by the CEA." Pet. App. 17a.[9]

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[9] Having read the "transactions in" clause of the Treasury Amendment broadly, the court nevertheless said that it chose "not to decide" whether Salomon was a "board of trade" brought back under the CEA through the "unless" clause of the Amendment. Pet. App. 11a n.5. In fact, however, the Fourth Circuit decided that issue. It repeatedly stated its holding that the "Treasury Amendment" as a whole covers Salomon's trading here (*see, e.g.*, Pet. App. 17a, 22a), and the court's opinion repeatedly equates "board of trade" with "organized exchange." *See* Pet. App. 15a-16a ("unless" clause addresses "futures transactions conducted *on an exchange*") (emphasis added); Pet. App. 20a ("[w]hat the statute commands . . . is the exemption of all trading off organized exchanges"). Indeed, that interpretation of "board of trade" underlies the court's very footnote purporting not to decide the "board of trade" issue (Pet. App. 11a & n.5), which indicates that Tauber, in pointing out that the trades here were conducted *off-exchange*, had conceded

The court of appeals further concluded that the legislative history supported its holding, relying on the fact that the Department of the Treasury proposed the Amendment and, in its letter to the appropriate Senate committee, expressly referred to "futures trading" as within the proposed Amendment. Pet. App. 18a. The court also speculated about the "likely . . . substantial market disruptions" that would result from reading the Amendment to cover only cash transactions (Pet. App. 19a), although it cited in support only two *amicus* briefs that carefully avoid any claim that existing off-exchange markets actually involve options or futures subject to the CEA's exchange-trading requirement, as opposed to "trade options" or "forwards." *See* U.S. Br. 1-10; Foreign Exch. Comm. Br. 1-13. In addition, the court rejected the notion that the Amendment was limited to interbank trading. Pet. App. 19a-20a.

The court of appeals went on to deny that its reading of the Amendment conflicted with the leading decisions (by the Second and Seventh Circuits) on the question. Pet. App. 21a-22a, discussing *CFTC v. American Bd. of Trade, Inc.*, 803 F.2d 1242 (2d Cir. 1986), and *Board of Trade v. SEC*, 677 F.2d 1137 (7th Cir.), *vacated as moot*, 459 U.S. 1026 (1982). The court did not dispute that those decisions expressly read the "transactions in"

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that Salomon was not a "board of trade" under the express CEA definition—although the very point of the argument is that "board of trade" extends beyond organized exchanges and, by its plain terms, fits Salomon perfectly, 7 U.S.C. § 1a(1) ("any . . . association, whether incorporated or unincorporated, of persons who are engaged in the business of buying or selling any commodity or receiving the same for sale on consignment").

Although this issue was not affirmatively raised in the district court (and does not arise if "transactions in" is properly construed), the district court expressly concluded that Salomon was *not* a "board of trade" based on equating the term with "organized exchange" (Pet. App. 35a-36a), and that conclusion was expressly challenged in the court of appeals (Tauber Br. 17 n.10; Tauber Reply Br. 17 n.11).

language of the Treasury Amendment in a manner contrary to its reading; indeed, the court acknowledged as much with respect to the Second Circuit decision. Pet. App. 21a. Nevertheless, the Fourth Circuit reasoned that the decisions were distinguishable from this case on their facts, because "both cases concerned *on-exchange* trading on behalf of the general public, not individual, large-scale deals between professionals." *Ibid.*

Consistent with that basis for distinguishing the other circuits' decisions on their facts, the Fourth Circuit finally sought to confine the impact of its ruling by asserting a possible limitation on its holding—without explaining the basis for the suggested limitation in its analysis of the Treasury Amendment. Although the court had unequivocally declared, consistent with its statutory analysis, that "*all* off-exchange transactions in foreign currency, including futures and options, are exempted from regulation by the CEA" under the Treasury Amendment (Pet. App. 17a (emphasis added)), the court indicated that "[t]his case does not involve mass marketing to small investors, which would appear to require trading through an exchange, and our holding in no way implies that such marketing is exempt from the CEA." Pet. App. 22a. "We hold only that individually-negotiated foreign currency option and futures transactions between sophisticated, large-scale foreign currency traders fall within the Treasury Amendment's exclusion from CEA coverage." *Ibid.*

REASONS FOR GRANTING THE PETITION

The court of appeals' interpretation of the Treasury Amendment should be reviewed, then reversed, by this Court. As the numerous *amicus* filings in the court of appeals indicate, the issue presented—the meaning of the Treasury Amendment, particularly whether it allows futures and options trading involving foreign currency, government securities, and other specified instruments to be freely moved off-exchange, outside the regulatory scheme

of the CEA, at the discretion of the trading parties—is of dramatic importance: it affects a very large share, perhaps more than half, of all the futures and options trading now conducted on exchanges. Moreover, the law on this important question is now in utter disarray, as the CFTC has recently recognized.[10] The Fourth Circuit's interpretation of the Treasury Amendment conflicts with the decisions of other circuits; and the federal government, through the CFTC and other interested agencies, has long been, and is at present, hopelessly inconsistent in its stated positions on the question. This Court should resolve the conflicts and clarify what is a fundamental legal issue—whether trading must continue on regulated exchanges—for a tremendous volume of economic activity.

Correction as well as clarification is needed in this case. In particular, the Treasury Amendment's key phrase, "transactions *in* foreign currency," naturally refers only to the sale of the actual currency—cash market transactions—rather than to transactions solely in *contracts*, such as futures and options, whose subject matter may be the commodity but which are not intended to result in any transfer of the underlying commodity. *See Chicago Mercantile Exch. v. SEC*, 883 F.2d 537, 542 (7th Cir. 1989), *cert. denied*, 496 U.S. 936 (1990) (futures trading "occurs in 'the contract,' not in the commodity"). This construction is supported by other CEA provisions, as well as by the CEA's comprehensive design to regulate futures and options, specifically including those involving foreign currency; and it reads the Amendment as a narrow exception, affecting only the CEA provisions that relate to *cash* transactions, just as the CFTC said in its contemporaneous interpretation of the Amendment in

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[10] *1993 CFTC Report* 6 (CFTC stating that "will consider recommending" legislation, "[i]n view of the prevalence of litigation over the scope of the Treasury Amendment, and the courts' lack of unanimity to which the recent Court of Appeals opinion contributes"). To our knowledge, no legislation has yet been recommended by the CFTC, much less agreed to by other government agencies or considered by Congress.

1975. *Cf. John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 114 S. Ct. 517, 524 (1993) (favoring "tight reading of exemptions from comprehensive schemes of this kind"). The Fourth Circuit's rejection of this interpretation, moreover, rests at every step on plain misunderstandings of CEA and on an overreading of one item in the legislative history. *See also* note 16, *infra* (meaning of "board of trade"). Consistent with the reading long established in the Second and Seventh Circuits, this Court should restore the Treasury Amendment to its proper place as a narrow exception to the CEA, not as a loophole through which most of the activity now regulated under the Act can slip.

A. THE ISSUE WARRANTS THIS COURT'S REVIEW

Even aside from its incorrectness, the Fourth Circuit's ruling warrants this Court's review because of its importance. The legal issue presented is one on which the circuit courts, and the federal government itself, are deeply divided. And the sheer practical impact of the ruling is staggering, reaching millions of futures and options contracts (involving billions of dollars) that, until now, were confined to regulated exchanges.

1. *Circuit Conflict.* The Fourth Circuit's ruling that the Treasury Amendment excludes transactions in options and futures involving foreign currency from the CEA, because they are "transactions in foreign currency," squarely conflicts with the law in the Seventh and Second Circuits. In *Board of Trade v. SEC*, *supra*, which involved government securities (like foreign currencies, listed in the Treasury Amendment), the Seventh Circuit held that sales of options are outside the "transactions in" language of the Treasury Amendment. 677 F.2d at 1154. The court reasoned that the Treasury Amendment, like other provisions of the CEA, "distinguishes 'transactions in' from 'transactions involving' " (*id.* at 1146 n.17) and explained that an "option transaction is a long step removed from a transaction *in* the commodity involved" (*id.* at 1154 (internal quotation marks omitted)). Be-

cause "transactions in" refers only to transactions in the actual commodity, the Seventh Circuit concluded, neither options nor futures are covered by the Amendment: "The futures or options contract is not a transaction in a commodity . . . ." *Id.* at 1154 n.33.[11]

The Second Circuit subsequently followed the Seventh Circuit's analysis in a case dealing with foreign currency. The Second Circuit likewise held that sales of options are not "transactions in" the commodity under the Treasury Amendment. *CFTC v. American Bd. of Trade, Inc.*, 803 F.2d at 1248. The court expressly concluded "that an option to buy or sell foreign currency is not a purchase or sale of the currency itself and hence is not a transaction 'in' that currency, but at most is one that relates to the currency." *Ibid.* (agreeing with *CFTC v. American Bd. of Trade, Inc.*, 473 F. Supp. 1177, 1182 (S.D.N.Y. 1979), and with *Board of Trade, supra*).[12]

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[11] The *Board of Trade* decision was vacated as moot when the underlying jurisdictional dispute between the CFTC and SEC was resolved by legislation in 1982. 7 U.S.C. §§ 2a(i), 6c(f). As the CFTC has explained, however, the decision "continues to be relied on by the Seventh Circuit as authoritative." *1993 CFTC Report* at 150 n.173; *see Chicago Mercantile Exch. v. SEC*, 883 F.2d at 544. The Second Circuit has likewise treated the *Board of Trade* decision as authoritative. *CFTC v. American Bd. of Trade, Inc.*, 803 F.2d at 1248. (Moreover, the 1982 statute that mooted the *Board of Trade* case plainly assumes the validity of the Seventh Circuit's interpretation of the Treasury Amendment. *See* pages 23-24, *infra*.)

[12] The Second Circuit also stated: "An option transaction giving the option holder the right to purchase a foreign currency by a specified date and at a specified price does not become a 'transaction[] in' that currency unless and until the option is exercised." 677 F.2d at 1248. The last phrase, in shorthand, necessarily means that if an option is exercised, producing an actual sale of the underlying commodity, that sale is a transaction "in" the commodity. That later sale, of course, if it occurs (it did not in this case), is a second transaction, distinct from the initial sale of the *option*. *See* CFTC C.A. Br. 19. As the Fourth Circuit recognized, it is the legality of the earlier transaction (the sale of the option) that is at issue in this case, and the answer to that question is unaffected by any later exercise of the option by a sale of the commodity.

This interpretation of the "transactions in" language in the Treasury Amendment was uniformly adopted by the federal courts prior to the district court decision in this case.[13] Indeed, it was characterized as "well-established" in a 1991 letter to Congress from a committee of the American Bar Association.[14] The construction of the Treasury Amendment adopted by the Fourth Circuit in this case is directly to the contrary.

This conflict cannot be sidestepped, as the Fourth Circuit attempted to do, by engrafting onto its ruling a limitation to trading by "sophisticated, large-scale" investors. Pet. App. 22a. Even aside from the intrinsic instability of so imprecise and uncertain a standard, the Fourth Circuit made no effort whatever to tie the asserted limit to the construction of the Treasury Amendment, and Salomon itself has argued that it is impossible to do so.[15] Rather, in its actual analysis of the statute, the Fourth Circuit explicitly and unequivocally concluded that "*all* off-exchange transactions in foreign currency, including

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[13] *See CFTC and State of Georgia v. Sterling Capital Co.*, Comm. Fut. L. Rep. (CCH) ¶ 21,169, at 24,783-84 (N.D. Ga.), *modified in other respects*, Comm. Fut. L. Rep. (CCH) ¶ 21,170 (N.D. Ga. 1981); *CFTC v. American Bd. of Trade, Inc.*, 473 F. Supp. 1177 (S.D.N.Y. 1979), *aff'd*, 803 F.2d 1242 (2d Cir. 1986). In mid-1993, another district court rejected the interpretation of the Treasury Amendment adopted by the district court in this case and held that the Treasury Amendment did not exclude at least some foreign currency futures trading from the CEA. *CFTC v. Standard Forex, Inc.*, No. CV-93-0088, slip op. 15-27 (E.D.N.Y. Aug. 9, 1993), *appeal pending*, No. 93-6255 (2d Cir.).

[14] *See Futures Trading Practices Act of 1991, Hearings on S. 207 Before the Senate Comm. on Agriculture, Nutrition, and Forestry*, 102d Cong., 1st Sess. 837-38 (1991) (letter from Committee on Futures Regulation of American Bar Association Section on Business Law) (discussing Seventh Circuit decision).

[15] Salomon C.A. Br. 23 ("as the district court definitively explained, the Treasury Amendment unambiguously exempts *all* off-exchange foreign currency transactions, without regard to the identity of the participants").

futures and options, *are exempted from regulation by the* CEA." Pet. App. 17a (emphasis added). By the same token, nothing whatever in the statutory interpretation adopted by the other circuits turns on whether the parties are "sophisticated" or wealthy. There is no basis for supposing that the Second or Seventh Circuits, having unmistakably held that the "transactions in" clause of the Treasury Amendment does not reach options and construed the phrase to refer only to transactions in the actual commodity itself, would repudiate that position in a case presenting facts having no bearing on their statutory analysis. Only wishful speculation could deny the present state of disagreement in the law applicable in different circuits.[16]

2. *Government Views.* The unsettled state of the law is only exacerbated by the wide divergence of views expressed by the federal government. Notably, the CFTC, the agency charged with administering the statute, has taken positions directly inconsistent with the Fourth Circuit's interpretation of the Treasury Amendment. With respect to *options,* the CFTC's only expressed view on the relevant issue squarely disagrees with the Fourth Circuit position. The CFTC told the Second Circuit in its brief in *American Bd. of Trade* (at 27-28) that it agreed with the Seventh Circuit's conclusion "that options to purchase a physical commodity are not transactions 'in' the commodity for purposes of the Treasury Amend-

[16] Similarly, to the extent that the court of appeals in this case necessarily held that a "board of trade" must be an organized exchange (*see* note 9, *supra*), its position conflicts with that of the Ninth Circuit. *CFTC v. Co Petro Mktg. Group, Inc.*, 680 F.2d at 581-82; *see also CFTC v. American Metal Exch. Corp.*, 693 F. Supp. 168, 176-79, 193 (D.N.J. 1988), *aff'd in part and vacated in part on other grounds*, 991 F.2d 71 (3d Cir. 1993). The Fourth Circuit's view is also in conflict with the longstanding view of the CFTC—which, in its brief in this case, deemed it essential to address this issue in order to resolve this case. CFTC Br. 12; *In re Stovall*, Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,779-82 & n.28 (Dec. 6, 1979); *CFTC Interpretive Letter No. 77-12* [1977-1980 Decisions] Comm. Fut. L. Rep. (CCH) ¶ 20,467, at 21,911-12 (Aug. 17, 1977).

ment." In the present case, the CFTC nowhere repudiated that position on the Treasury Amendment's inapplicability to the sale of options.[17]

With respect to *futures*, the CFTC's initial interpretation of the Treasury Amendment, all but contemporaneous with its enactment, took precisely the position we urge, explaining that the Amendment "was intended to make clear that the CFTC would not have any jurisdiction with respect to the purchase and sale of the enumerated financial instruments themselves (the 'cash market'), but would have jurisdiction solely with respect to futures trading in those instruments." *SEC-CFTC Jurisdictional Correspondence, supra*, at 20,834. The CFTC explained that the Amendment was meant to ensure that the manipulation, reporting, and other provisions of the CEA applicable to *cash-market* transactions would not be applied to the transactions routinely conducted by banks in the listed financial instruments, which were already subject to federal banking authorities' regulations. *Ibid.* In 1985, the CFTC changed course, issuing a "statutory interpretation and request for comments," which indicated that, although the Treasury Amendment does *not* cover futures trading with the general public, it might cover futures and other transactions "among and between banks and other sophisticated, informed institutions." 50 Fed. Reg. 42,983, 42,984 (1985). In its brief in the present case, the CFTC reiterated that position, vigorously disagreeing with the district court's interpretation of the Amendment but then arguing that the Amendment is ambiguous, freeing the courts to adopt the CFTC's "sophisticated institutions" view as reflecting congressional intent. CFTC Br. 11-19.[18]

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[17] The CFTC brief in the Fourth Circuit avoided the question as to the legality of the sale of options, stating (at 19-20) that the district court here had focused only on "exercised" options contracts. As noted above, the Fourth Circuit correctly understood that the question could not thus be avoided.

[18] The CFTC took the same position in *Standard Forex* and in its 1993 Report to Congress (at 153-55), where it also noted that the

The Department of the Treasury has itself taken different positions. At the time the Amendment was being proposed, the Department referred to the proposal as covering "futures," but it nowhere mentioned options. *See* S. Rep. 1131, *supra*, at 49-51. In 1978, on the other hand, the Department described the market that the Treasury Amendment was designed to remove from CEA coverage as a *forwards* market, not a *futures* market. S. Rep. 850, 95th Cong., 2d Sess. 46 (1978).[19] In 1986, however, the Department wrote a letter to the CFTC (dated May 5, 1986), challenging the CFTC's 1985 "statutory interpretation" and arguing that the Amendment "places outside the coverage of the Act all off-exchange future transactions in the listed financial instruments," without regard to "the characteristics of participants in a transaction." And in this case, the "United States"—apparently presenting the views of the Department of the Treasury and, perhaps, those of the SEC as well[20]—filed a brief in the Fourth Circuit that expressly

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Fourth Circuit's "legislative analysis is inconsistent in some respects" with the analysis adopted at the CFTC's urging by the district court in *Standard Forex. 1993 CFTC Report* 155-56.

[19] The Department's 1978 letter to Congress recognized both the practical similarity and the legal distinctness of the on-exchange and off-exchange trading: whereas "the CFTC has jurisdiction over *futures* trading based on Government securities," the off-exchange market involves "contracts for *forward* delivery, some of which have elements in common with trading in *futures* contracts on organized exchanges." S. Rep. 850, *supra*, at 47, 46 (emphasis added); *see id.* at 47 (off-exchange "trading activity of a similar nature to futures contract trading on an exchange").

In 1986, the Comptroller of the Currency, in a letter to the CFTC (dated Apr. 11, 1986) commenting on the "statutory interpretation and request for comments," described the interbank market as involving "forward FX transactions" and said that "the 1975 Treasury amendment . . . exempted certain forward transactions in foreign exchange by banks."

[20] The SEC did not separately appear on or sign the brief "for the United States," but the interests of the SEC are discussed in

disagreed with the Second and Seventh Circuit's construction of the Treasury Amendment (U.S. Br. 21-22) and instead agreed with the district court's holding that the Amendment excludes all futures and options from the CEA, regardless of who the traders are (U.S. Br. 13-18). This cacophony of views from the government, which reflects longstanding jurisdictional battles as well as policy differences, is obviously persistent, contributing to the deeply unsettled state of the law on the question presented.

3. *Practical Consequences.* Without doubt, the decision in this case "will have far-reaching effects." Pet. App. 13a. The precise impact depends on exactly what types of instruments may qualify as "foreign currency," "government securities," or any of the other potential commodities listed in the Treasury Amendment. What is not disputable is that a very large percentage, perhaps well over half, of the hundreds of millions of futures and options contracts currently traded on the regulated exchanges would be excluded from regulation if, as the Fourth Circuit concluded, the Amendment covers futures and options.[21]

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the "interest of *amicus*" section. More recently, on October 28, 1993, SEC Commissioner Beese presented testimony on behalf of the SEC (to the House Committee on Banking, Finance and Urban Affairs) expressing the view that options and futures involving foreign currency generally remain subject to the CEA (and hence must be outside the reach of the Treasury Amendment): under the 1982 legislation enacted in response to the Seventh Circuit's *Board of Trade* decision, he said, "the CFTC retained exclusive jurisdiction over all futures contracts . . . and options on . . . foreign currency (except if traded on a securities exchange)." Testimony at 3 (footnotes omitted).

[21] "The nearly twenty-nine million foreign currency futures contracts traded in 1991 accounted for more than 12 percent of futures transactions in the United States. The seventy-eight million futures contracts on government securities accounted for about 30 percent of United States futures trading and more than 70 percent of the [Chicago Board of Trade's] annual volume." P. Johnson & T. Hazen, *supra*, at 136 n.3b (Supp. 1992). *See also* CFTC, *Annual*

Under the Fourth Circuit's ruling that "all off-exchange transactions in foreign currency, including futures and options, are exempted from regulation by the CEA" (Pet. App. 17a), all of that trading could be moved off-exchange, and removed from all of the regulatory protections under the CEA, at the discretion of the traders. The result would be essentially identical even under the Fourth Circuit's announced limitation of its ruling (for now) to "professionals," who make up virtually the entire market. Pet. App. 21a; *id.* at 22a ("sophisticated, large-scale foreign currency traders").[22] As a practical matter, then, the Fourth Circuit permits outright deregulation of a very great deal, perhaps most, of the trading currently subject to CEA regulation. *See* P. Johnson & T. Hazen, *supra*, § 4.36, at 136 (Supp. 1992) (under district court's "extremely controversial" interpretation, "the door has been opened for off-exchange trading in foreign currency futures, Treasury Bond futures, and other financial instruments identified in the Treasury Amendment"). That extraordinary consequence is sufficient by itself to justify review, especially in light of the

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Report 1992, at 93-104 (almost 300 million futures contracts and 70 million options contracts in 1992; figures for various regulated exchanges); *Futures Trading Practices Act, supra*, at 533 (government securities options trading on Chicago Board of Trade exceeds $11 billion daily).

[22] *See Exemption for Certain Contracts Involving Energy Products*, 58 Fed. Reg. 21,286, 21,296 (1993) (dissenting opinion of Comm'r Bair) ("approximately 98% of users of regulated, exchange-traded futures" meet "sophistication" standard): *Futures Trading Practices Act, supra*, at 533 ("Public retail customer participation in Chicago Board of Trade markets is negligible—approximately one to three percent of exchange volume.").

This is not a fanciful concern. The major futures exchanges have recently shown active interest in removing large amounts of their trading from much or all regulation: *e.g.*, the Chicago Board of Trade has petitioned the CFTC for a broad "professional trader" exemption from the CEA. 58 Fed. Reg. 43,414, 43,431 (1993).

concededly serious risks of unregulated futures and options trading.[23]

B. THE FOURTH CIRCUIT'S RULING IS INCORRECT

The court of appeals' decision should be reviewed not only because the question is important but also because the ruling is wrong. The best reading of the Treasury Amendment is the one that was established in the courts before the district court decided this case and that is consistent with the CEA's comprehensive coverage of futures and options trading: the Amendment narrowly excludes only transactions in the actual commodity from the CEA (specifically, from the manipulation and reporting requirements applicable to such transactions); it does not deregulate futures, options, or other transactions in which only *contracts* are traded (where the parties do not effect or have an interest in an actual transfer of the underlying commodity). For reasons briefly set out below, the Fourth Circuit's rejection of that construction rests on critical errors at every step in its statutory analysis.[24]

1. *Statutory Language.* The key words of the Treasury Amendment, "transactions in [a commodity]," are

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[23] *See* Laing, "The Next Meltdown? Fears Grow That Derivatives Pose a Big Threat," *Barron's*, June 7, 1993, at 15 (interview with Salomon's chairman, Warren Buffett) (Buffett "opined that derivatives might one day trigger a catastrophic 'chain reaction' in world financial markets. For one thing, he explained, the derivatives market lacks the restraints of exchange-traded futures and options —namely, the posting of margin by both buyers and sellers, daily marking to the market and margin adjustments of positions and the guaranteeing of the integrity of all trades by some centralized clearing house with broad assessment powers.").

[24] As to the Fourth Circuit's equating of "board of trade" with "organized exchange" (*see* note 9, *supra*), we note here only that it contradicts the explicit statutory definition of "board of trade," which by its terms covers a firm like Salomon that is in the business of buying and selling financial instruments that are commodities under the CEA. *See* 7 U.S.C. § 1a(1). This question needs to be reached as a separate issue only if this Court accepts the Fourth Circuit's interpretation of the "transactions in" language.

naturally read to refer to a transaction designed to effect an actual transfer of the commodity. With the purchase or sale of a mere option, or of a futures contract (where delivery is not intended), the trading "occurs in 'the contract', not in the commodity." *Chicago Mercantile Exch. v. SEC*, 883 F.2d at 542 (per Judge Easterbrook). A broader phrase, such as "in respect to" (7 U.S.C. § 3) or "in connection with" (7 U.S.C. § 6) or "involving" (7 U.S.C. § 2(i), (ii)), was readily available if Congress wished to reach more broadly. *See Board of Trade*, 677 F.2d at 1146. And when Congress elsewhere used the phrase, "transactions *in* government securities" (15 U.S.C. § 78*o*-5), it made clear (with an eye on the Treasury Amendment) that the phrase covered only actual sales of the government securities, *not* "trading in government securities futures" (S. Rep. 426, 99th Cong., 2d Sess. 23 (1986)).

This reading not only fits the statutory language, and accords with the CFTC's contemporaneous interpretation (*see SEC-CFTC Jurisdictional Correspondence, supra*) and consistent judicial precedent prior to this case, but is confirmed by at least two other directly relevant provisions of the CEA. First, if futures and options are covered by the Treasury Amendment (7 U.S.C. § 2(ii)), it is more than a little surprising that the CEA's grant of exclusive jurisdiction over futures and options in the very preceding provision (7 U.S.C. § 2(i)) makes no exception for the Amendment.[25] Instead, the exclusive-jurisdiction provision identifies another provision (7 U.S.C. § 2a) as the sole exception. Second, when Congress responded to the Seventh Circuit's *Board of Trade* decision, it did so, *not* by repudiating the *Board of Trade* interpretation

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[25] In 1992, Congress cleaned up the "extremely confusing . . . organization" of Section 2(a)(1)(A) of the CEA, with definitional provisions now separately codified in 7 U.S.C. § 1a. S. Rep. 22, *supra*, at 48. The textual point made above, however, fully applies to the pre-1992 provision. Congress intended "[n]o substantive changes in law" by its 1992 reorganization. *Ibid.*; *see* H.R. Conf. Rep. 978, 102d Cong., 2d Sess. 72 (1992).

of the Treasury Amendment, but instead by adding a new exclusion for "any transaction in an option on foreign currency traded on a national securities exchange" (7 U.S.C. § 6c(f)). That provision not only takes the *Board of Trade* reading of the Treasury Amendment as a given (*see Chicago Mercantile Exch. v. SEC*, 883 F.2d at 544 ("[t]he legislation . . . left in place the premise on which [*Board of Trade*] was founded")), but reaffirmed Congress's insistence that options trading take place on a regulated exchange.

The Fourth Circuit did not dispute the natural meaning of the words "transactions in"; indeed, it seemed to acknowledge at least the availability of this interpretation. Pet. App. 16a-17a. Rather, the court relied on four textual arguments to read the phrase more broadly. But each of the arguments—aside from applying only to futures, without any further reasoning to justify the jump to options—is patently flawed.

First, the court's statement that the "transactions in" clause of the Amendment must encompass futures because the "unless" clause does (Pet. App. 15a-16a) rests on a false premise. The "unless" clause refers to transactions that "involve" futures, not transactions "in" futures; and a cash sale of a commodity does involve a future when it is the result of performing a future—an unusual, unplanned, but regular occurrence. *See Merrill Lynch*, 456 U.S. at 359 n.9 ("about '3% of all futures contracts traded are normally settled by an actual delivery' ") (quoting H.R. Rep. 975, 93d Cong., 2d Sess. 149 (1974)). The "unless" clause thus refers to *cash* transactions, and so there is no basis for insisting that the "transactions in" clause must be read, contrary to its most natural meaning, to reach beyond cash transactions.[26]

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[26] The Seventh Circuit explained: "The purpose of the 'unless' clause . . . is not to except . . . options or futures from the Treasury amendment. Rather, the 'unless' clause is needed (and was enacted) to except the transactions in [the instruments listed in the Amend-

Second, the Fourth Circuit's statement that the Treasury Amendment would be redundant if it excluded only forwards and other cash transactions (Pet. App. 16a) rests on the false assumption that cash forwards are already completely excluded from the CEA. In fact, cash forwards are excluded only from the definition of "future delivery" (7 U.S.C. § 1a(11)), leaving them entirely subject to the various provisions of the CEA that regulate cash transactions—as the CFTC explained in 1975. *See* pages 5, 18, *supra*. The Treasury Amendment, by contrast, lifts those cash-transaction requirements, because it is an exemption from the CEA as a whole ("Nothing in this Act . . ."). The Fourth Circuit's redundancy reasoning simply misreads the CEA.

Third, the court's doubt that the "transactions in" phrase could encompass cash forwards without also encompassing futures contracts (Pet. App. 16a-17a) misunderstands the distinguishing characteristic of cash forwards. An actual delivery of the underlying commodity is planned with a forwards contract, and so entry into such a contract is not a mere "transaction in *contracts*" (Pet. App. 17a), but a bona fide commodity sale, with delivery merely deferred. In contrast, entry into a futures contract *is* only a transaction in a contract, for its defining characteristic is that no transfer of an underlying commodity is contemplated. *See* note 5, *supra*.

Finally, the court of appeals' remaining textual argument—that 7 U.S.C. § 5 uses "transactions in" to refer to "all transactions *involving* the commodity" (Pet. App. 17a)—both misreads and places undue reliance on one other CEA provision. Thus, the phrase relied on

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ment] that occur when a futures contract is actually performed or an option is exercised. The futures or options contract is not a transaction in a commodity but insofar as it may presage some future transfer of the commodity, the latter is excepted from the Treasury amendment by the 'unless' clause." *Board of Trade*, 677 F.2d at 1154 n.33.

by the Fourth Circuit ("transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as 'futures' ") cannot refer to all transactions involving the commodity, because *options* are separately addressed later in the same provision. 7 U.S.C. § 5 (last two sentences). More pointedly, the provision does not use "transactions in [commodities]" standing alone (as the Treasury Amendment does), but as part of a phrase that specifically includes the words "future delivery"—words that the CEA uses *whenever* referring to futures, and which are conspicuously absent in the relevant language of the Treasury Amendment. In any event, since other CEA provisions reinforce the distinction between transactions "in" and transactions "involving" (7 U.S.C. § 16(e)) and between transactions in commodities and transactions in futures or options (7 U.S.C. § 13(d)), usage comparisons among CEA provisions are of questionable weight: as Salomon explained in the Fourth Circuit, "it is impossible to impose a model of precise, single-author draftsmanship on a statutory scheme that is a patchwork of many different Acts and amendments subsequently embroidered upon the initial enactment of 1921." Salomon Br. 17. In sum, nothing in the Fourth Circuit's textual analysis justifies rejection of the natural "cash transactions" meaning of the Treasury Amendment.[27]

2. *Legislative History and Policy.* The Fourth Circuit was also wrong in its reliance on legislative history to support its reading of the Treasury Amendment. That reliance rests entirely on a single item in the legislative materials leading to enactment of the Amendment as part of

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[27] As noted, the Fourth Circuit provided no analysis whatever to justify its effort to limit the consequences of its reading of the Treasury Amendment by declaring its holding restricted to trading by large investors—a restriction that Salomon and the United States have both argued is without any foundation in the Amendment. Pet. App. 22a.

the 1974 expansion of the CEA: the letter from the Department of the Treasury making the initial formal proposal for a provision that, as modified by Congress, became the Amendment. Pet. App. 18a. Without that letter, there would be no remotely plausible argument for the Fourth Circuit's view based on legislative history. But there are a number of reasons—over and above the heavy burden of justifying a departure from the construction supported by the text—why the fact that the Department's letter used the term "futures" is not enough to justify the Fourth Circuit's construction of the Amendment as removing both options and futures from the coverage of the CEA.

First, the Department's letter nowhere even hints that the proposed Amendment covers *options* involving the listed commodities. (In fact, Congress deleted the options included among the listed commodities in Treasury's proposal.) *See* S. Rep. 1131, *supra*, at 49-51. Second, no one in *Congress*—not a Committee, not a Senator, not a Representative—ever asserted that the Amendment was to cover even "futures," let alone options; accordingly, as the Seventh Circuit explained, there are "no grounds to believe that the Senate Committee adopted the opinion of the Treasury Secretary concerning the scope of the Treasury amendment." *Board of Trade*, 677 F.2d at 1155 n.34. Indeed, the congressional committees' avoidance of any reference to "futures" or "options" in their own descriptions of the Amendment suggests disagreement with Treasury's apparent view. *See* S. Rep. 1131, *supra*, at 23 ("trading *in* foreign currencies") (emphasis added); *id.* at 6 ("trading *of* foreign currencies") (emphasis added); H.R. Conf. Rep. 1383, 93d Cong., 2d Sess. 35 (1974) (same). Third, there is reason to think that the Treasury Department itself erred in referring to the existing interbank market as a "futures" market, because in 1978 Treasury clearly described that market as involving "forwards"—which, it acknowledged,

bore similarities to futures. *See* note 19, *supra*.[28] For those reasons, the Department's reference in its letter is at best a very weak basis for inferring congressional intent.

On the other side, the legislative history supplies evidence of Congress's intent that powerfully undermines the Fourth Circuit's position. Thus, even as the Treasury Amendment was being proposed, the congressional committees specifically included foreign currency among the commodities they insisted be brought under the CEA by expansion of the "commodity" definition. S. Rep. 1131, *supra*, at 19; H.R. Rep. 975, *supra*, at 41, 153-54. The Fourth Circuit's reading of the Amendment means, implausibly, that the committees *sub silentio* reversed that intended coverage. Moreover, under the Fourth Circuit's reading, firms like Salomon Forex are free to engage in trading of futures and options without *any* federal regulation or any connection to an interest in the underlying commodity. That result is hardly consistent with the congressional "intent to fill all regulatory gaps" (120 Cong. Rec. 34736, 34997 (1974) (statement of conference managers)) or, indeed, with the narrower goal to avoid *dual* regulation of certain kinds of trading by banks (*see Board of Trade*, 677 F.2d at 1154)—which would, ordinarily, be expected to have an interest in the underlying currency or financial instruments listed in the Amendment.

Finally, and most broadly, the Fourth Circuit's expansive reading of the Treasury Amendment flies in the face of the pervasive congressional insistence that trading of futures and options be regulated. *See, e.g., In re Stovall, supra*, at 23,779-80 ("Congress endeavored to

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[28] In fact, the problem that led to the Treasury Amendment was first raised *not* by the Treasury Department but by an official from the Chase Manhattan Bank, who specifically contrasted the "commodity futures market" from the "interbank foreign exchange market." *Commodity Futures Trading Commission Act, Hearings on S. 2485 et al. Before the Senate Comm. on Agriculture and Forestry*, 93d Cong., 2d Sess. 771-72 (1974).

force *all* futures transactions, as opposed to cash-deferred future delivery transactions, onto regulated contract markets, which, as a result of government oversight, were to be free from manipulations and other market disturbances."). Even today, exemptions are authorized only under the conditions deemed appropriate by the CFTC (7 U.S.C. §§ 6(c), 6c) or under SEC supervision (7 U.S.C. § 6c(f)). Absent extraordinary evidence, an exception to a comprehensive regulatory scheme should not be read to undermine the most fundamental policies of the statute (*see John Hancock, supra*) and, even more strangely, to make subjection to the regime entirely voluntary with the regulated parties. That is the result the Fourth Circuit's reading of the Treasury Amendment produces.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: February 15, 1994

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 92-1406

SALOMON FOREX, INCORPORATED,
Plaintiff-Appellee,

v.

LASZLO N. TAUBER, M.D.,
Defendant & Third Party Plaintiff-Appellant,

and

LASZLO N. TAUBER, M.D. AND ASSOCIATES,
Defendant,

v.

SALOMON BROTHERS, INCORPORATED; SALOMON, INCORPORATED; FRED GATLING,
Third Party Defendants-Appellees,

and

PAUL MOZER,
Third Party Defendant.

THE BOARD OF TRADE OF THE CITY OF CHICAGO; CHICAGO MERCANTILE EXCHANGE; UNITED STATES OF AMERICA; FUTURES INDUSTRY ASSOCIATION, INCORPORATED; MANAGED FUTURES ASSOCIATION; FOREIGN EXCHANGE COMMITTEE; COMMODITY FUTURES TRADING COMMISSION; STATE OF IDAHO, DEPARTMENT OF FINANCE; NEVADA SECURITIES DIVISION OF THE OFFICE OF THE SECRETARY OF STATE,
Amici Curiae.

Appeal from the United States District Court for the Eastern District of Virginia, at Alexandria
T. S. Ellis, III, District Judge

(CA-91-1415-A)

Argued: May 6, 1993

Decided: October 18, 1993

Before PHILLIPS, NIEMEYER, and WILLIAMS, Circuit Judges.

Affirmed by published opinion. Judge Niemeyer wrote the opinion, in which Judge Phillips and Judge Williams joined.

OPINION

NIEMEYER, Circuit Judge:

This appeal, taken from the district court's enforcement of a trading debt, squarely presents the issue of whether professional traders may individually negotiate sales of foreign currency futures and options off organized exchanges without violating the Commodities Exchange Act, 7 U.S.C. § 1, *et seq.* Finding that the Act is inapplicable to such trading and that there are no other defenses to enforcement of the debt in question, we affirm the judgment of the district court.

I

Over the course of 2½ years Dr. Laszlo N. Tauber, a surgeon from northern Virginia, entered into 2,702 transactions with Salomon Forex, Inc. and related entities, each transaction involving the sale of foreign cur-

rency futures[1] and options. Tauber's trading with Salomon Forex was just one aspect of his dealings in foreign currency, which were on a large scale. During the relevant period, Tauber traded with more than a dozen other companies besides Salomon Forex, exchanging billions of dollars worth of currency. He compared prices from various sources and bought currency at the most advantageous rate, often using one transaction to cover the risks of another. Tauber individually negotiated terms for these currency transactions, both with Salomon Forex and with other companies.

Tauber's wholly-owned foreign currency trading company, Westwood Options, Inc., holds a seat on the nation's largest foreign currency exchange, the Philadelphia Stock Exchange. Tauber himself is worth, by the estimate of the district court, over half a billion dollars, and he owns extensive real estate holdings as well as foreign currency investments. Tauber maintains foreign bank accounts which he uses to carry out foreign currency transactions and uses foreign currency mortgages in connection with his real estate ventures. While Tauber was trading with Salomon Forex, Salomon Forex did not conduct trading of this type with any other individual investor—all of Salomon Forex's other foreign currency investment clients were institutions. The district court found that Tauber is a "sophisticated foreign currency trader."

Tauber's dealings with Salomon Forex involved foreign currency solely as an investment; they were not aimed at the acquisition of actual foreign currency. Rather than take physical delivery of the actual currency he purchased from Salomon Forex, Tauber typically entered

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[1] While Salomon Forex characterizes these transactions as forwards rather than futures, the district court declined to resolve the contracts' nature, noting that summary judgment is appropriate whether the contracts are futures or forwards. The difference between a forward and a future is discussed in Part II, below.

into counterbalancing transactions with Salomon Forex by the time the contract matured. Initially, Salomon Forex's staff would contact Tauber's staff to inquire as to where currency was to be delivered when a contract matured. Salomon Forex later began placing the legend "Always Nets to Zero" on the written confirmation notices for Tauber's transactions. Only four of the Tauber-Salomon Forex contracts resulted in delivery of actual currency.

In March 1991, Tauber's investments, particularly in Swiss francs, declined sharply in value and Salomon Forex demanded that Tauber cover his open positions. When Tauber failed to do so, Salomon Forex ceased trading with him. Just over $25 million became due and payable under 68 futures contracts that matured in July and August 1991, leaving Tauber with a total outstanding account balance of $30 million owing to Salomon Forex. After applying $4 million in collateral that it was holding to this balance, Salomon Forex billed Tauber for almost $26 million. When Tauber refused to pay, Salomon Forex brought this suit. Tauber responded with numerous defenses, contending that the transactions he negotiated with Salomon Forex were illegal under the Commodities Exchange Act and that therefore he should not be held responsible for them. Tauber also argued that his contracts are void as violating New York state law. With his answer, Tauber filed counterclaims for negligence and for breach of contract. On Salomon Forex's motion for summary judgment, the district court entered judgment in favor of Salomon Forex, finding that Tauber had not met his burden of presenting evidence that he had any viable counterclaim or defense to his debt. This appeal followed.

II

The central issue in this case is whether Congress intended transactions such as those between Salomon Forex and Tauber to be regulated by the Commodities Exchange

Act ("CEA"). In order to resolve this issue, it is first necessary to understand the history and purpose of that Act.

Congress enacted the Futures Trading Act, Pub. L. No. 67-66, 42 Stat. 187, in 1921 to regulate boards of trade on which futures trading occurred, primarily to prevent price manipulation and what many perceived as excessive speculation in grains. *See* William L. Stein, *The Exchange-Trading Requirement of the Commodity Exchange Act*, 41 Vand. L. Rev. 473, 477 & n.23 (1988) (collecting relevant legislative history). The Act also sought to eliminate "bucket shops," businesses that offered small investors the opportunity to speculate, and indeed even wager, on the price of commodities through unreported deals. While a bucket shop typically attempted to match a customer order exposing the shop to the risk of upward price movement with an order exposing it to the risk of a downward movement, it nevertheless purported to assume the risk of any net positions. When, however, the market prices moved adversely to the bucket shop's net position, it usually closed, leaving behind uncollectible debts.

One year after its passage, the Futures Trading Act was declared unconstitutional as an improper exercise of the taxing power. *See Hill v. Wallace*, 259 U.S. 44 (1922). Congress swiftly responded with the Grain Futures Act of 1922, Pub. L. No. 67-331, 42 Stat. 998, which derived its authority from the broad powers granted by the Commerce Clause. Numerous changes and amendments followed over the years, and the statutory framework established by the Grain Futures Act gradually developed into the Commodities Exchange Act in its present form. *See* 7 U.S.C. §§ 1-25.

Today the CEA establishes a comprehensive system for regulating futures contracts and options. It provides at its core that no person shall enter into, or offer to enter into, a transaction involving the sale of a "com-

modity for future delivery," unless it is conducted on or through a board of trade designated and regulated by the Commodity Futures Trading Commission ("CFTC") as an exchange ("contract market"). *See* 7 U.S.C. §§ 2, 6. The Act also regulates transactions of the character of an option. *See* 7 U.S.C. § 6c.

Because the Act was aimed at manipulation, speculation, and other abuses that could arise from the trading in futures contracts and options, as distinguished from the commodity itself, Congress never purported to regulate "spot" transactions (transactions for the immediate sale and delivery of a commodity) or "cash forward" transactions (in which the commodity is presently sold but its delivery is, by agreement, delayed or deferred). Thus § 2a(1)(A) of the Act, 7 U.S.C. § 2, provides that "futures" regulated by the Act do not include transactions involving actual physical delivery of the commodity, even on a deferred basis. Transactions in the commodity itself which anticipate actual delivery did not present the same opportunities for speculation, manipulation, and outright wagering that trading in futures and options presented. From the beginning, the CEA thus regulated transactions involving the purchase or sale of a commodity "for future delivery" but excluded transactions involving "any sale of any cash commodity for deferred shipment or delivery." 7 U.S.C. § 2. The distinction, though semantically subtle, is what the trade refers to as the difference between "futures," which generally are regulated, and "cash forwards" or "forwards," which are not. *See generally* David J. Gilberg, *Regulation of New Financial Instruments under the Federal Securities and Commodities Laws*, 39 Vand. L. Rev. 1599, 1603-08 (1986) (discussing distinction between futures and forwards); Lewis D. Solomon & Howard B. Dicker, *The Crash of 1987: A Legal and Public Policy Analysis*, 57 Fordham L. Rev. 191, 193-96 (1988) (describing evolution of forwards and futures); Stein, *supra*, at 486-92 (detailing legislative history of forward/future distinc-

tion); Mark D. Young & William L. Stein, *Swap Transactions under the Commodity Exchange Act: Is Congressional Action Needed?*, 76 Geo. L. J. 1917, 1923-24 (1988) (describing distinction between forwards and futures).

A "futures contract," or "future," never precisely defined by statute, nevertheless has an accepted meaning which brings it within the scope of transactions historically sought to be regulated by the CEA. It is generally understood to be an executory, mutually binding agreement providing for the future delivery of a commodity on a date certain where the grade, quantity, and price at the time of delivery are fixed. To facilitate the development of a liquid market in these transactions, these contracts are standardized and transferrable. Trading in futures seldom results in physical delivery of the subject commodity, since the obligations are often extinguished by offsetting transactions that produce a net profit or loss. The main purpose realized by entering into futures transactions is to transfer price risks from suppliers, processors and distributors (hedgers) to those more willing to take the risk (speculators).[2] Since the prices of futures are contingent on the vagaries of both the production of the commodity and the economics of the marketplace, they are particularly susceptible to manipulation and excessive speculation.

In contrast to the fungible quality of futures, cash forwards are generally individually negotiated sales of commodities between principals in which actual delivery of the commodity is anticipated, but is deferred for reasons of commercial convenience or necessity. These contracts are not readily transferable and therefore are usually en-

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[2] In addition to transferring risk, futures trading increases consumers' knowledge of future price trends in a commodity by providing incentives to study and forecast its supply and demand. *See United States v. Dial*, 757 F.2d 163, 165 (7th Cir.), *cert. denied*, 474 U.S. 838 (1985).

tered into between parties able to make and receive physical delivery of the subject goods.

This case also involves a third type of instrument, options or option contracts, which are defined by traditional contract principles. Unlike futures and cash forwards which create mutually binding obligations, the option holder incurs no obligation, but rather pays a fee or other consideration for obtaining the enforceable obligation of the option giver to sell or buy upon demand. Thus, the total risk assumed in purchasing an option is the loss of the fee. A commodity option confers on its holder the right, but not the obligation, to buy (a "call option") or to sell (a "put option") a specific amount of a commodity at a fixed price by a date certain.

The present controversy centers on the 1974 amendments to the CEA, in which Congress greatly expanded the scope of the Act's regulation. Act of Oct. 23, 1974, 88 Stat. 1389 (codified as amended at 7 U.S.C. §§ 1-25). The definition of "commodity" was substantially broadened to include, in addition to specified agricultural products, "all other goods and articles . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in," except for specific items not relevant to the present discussion. *See* 7 U.S.C. § 1a. Because the CEA uses the term "commodity" in setting the jurisdiction of the CFTC, that agency's jurisdiction under the Act was greatly expanded by this redefinition. *See* 7 U.S.C. § 2.

The General Counsel of the Department of the Treasury, in response to the prospect of this proposed expansion of the definition of "commodity," wrote a letter to the Senate Committee on Agriculture and Forestry on behalf of the Department. In this letter he proposed explicit recognition of an exception to CEA coverage which he assumed Congress to have implicitly intended, that off-exchanged trading of foreign exchange futures was not to

be regulated under the CEA. This letter stated, in pertinent part:

> The Department believes the bills contain an ambiguity that should be clarified. The provisions of the bills do not clearly indicate that the new regulatory agency's authority would be limited to the regulation of futures trading on organized exchanges, and would not extend to futures trading in foreign currencies off organized exchanges. We do not believe that either the House of Representatives or your Committee intends the proposed legislation to subject the foreign currency futures trading of banks or other institutions, other than on an organized exchange, to the new regulatory regime.
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> The Department feels strongly that foreign exchange futures trading, other than on organized exchanges, should not be regulated by the new agency. Virtually all futures trading in foreign currencies in the United States is carried out through an informal network of banks and dealers. This dealer market, which consists primarily of the large banks, has proved highly efficient in serving the needs of international business in hedging the risks that stem from foreign exchange rate movements. The participants in this market are sophisticated and informed institutions, unlike the participants on *organized* exchanges, which, in some cases, include individuals and small traders who may need to be protected by some form of governmental regulation.
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> Where the need for regulation of transactions on other than organized exchanges does exist, this should be done through strengthening existing regulatory responsibilities now lodged in the Comptroller of the Currency and the Federal Reserve. These agencies are currently taking action to achieve closer supervision of the trading risks involved in these activities. The Commodity Futures Trading Com-

> mission would clearly not have the expertise to regulate a complex banking function and would confuse an already highly regulated business sector. Moreover, in this context, new regulatory limitations and restrictions could have an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors.

S. Rep. No. 1131, 93d Cong., 2d Sess. 49-51 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5843, 5887-89.[3]

To establish the recommended exclusion, the Treasury Department proposed an amendment, which was adopted almost verbatim and ultimately codified at 7 U.S.C. § 2:

> Nothing in this chapter [7 U.S.C. § 1, *et seq.*] shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

7 U.S.C. § 2.[4] It is this language, known as the Treasury Amendment, which Salomon Forex contends exempts the transactions between it and Tauber from regulation by the CEA.

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[3] The Treasury letter goes on to express concern with regulation of markets in various other types of financial instruments, including, for example, installment loan contracts and futures trading in mortgages. Because such transactions are generally between large and sophisticated investors, the Treasury recommended that they also not be made to fall within the coverage of the CEA.

[4] The sole change Congress made in the amendment was that whereas the Treasury's version would have excluded from CEA regulation "puts and calls for securities," these were not excluded under the enacted version.

III

Tauber's principal defense rests on the ground that his transactions with Salomon Forex are unenforceable because they violate the CEA. Tauber claims that the CEA requires that foreign currency futures be traded exclusively on exchanges designated by the CFTC and that options be traded either on such exchanges or on securities exchanges designated by the Securities Exchange Commission. 7 U.S.C. §§ 6, 6c(b), 6c(f). Resting on the Act's broad definition of commodity, *see* 7 U.S.C. § 2, which all parties concede includes foreign currency, and the requirement that transactions involving the purchase or sale of a commodity for future delivery must be conducted on a regulated exchange, Tauber argues that these transactions are illegal "because the foreign currency futures transactions at issue in this case took place *off any exchange*." [5] (Emphasis added).

In response to the district court's conclusion that Tauber's transactions were exempted from CEA regulation by the Treasury Amendment, which exempts from regulation all off-exchange "transactions in foreign currency," Tauber argues that the exemption applies only to "transactions in the actual commodity." The purchase or sale of options or futures is not, he maintains, "in that natural sense, a transaction in the commodity itself." He contends that the Treasury Amendment was intended only to exempt from regulation "spot" transactions (involving the immediate sale and conveyance of a commodity) and "cash forward" transactions (involving a present sale with deferred delivery), neither of which, he argues, describes his transactions with Salomon Forex.

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[5] While it has been Tauber's position before the district court and on appeal that his transactions were conducted off exchange, after an amicus brief suggested that Salomon Forex is a "board of trade" as used in 7 U.S.C. § 2, Tauber stated that he agreed. While we would be inclined to reject that position, we choose not to decide its validity since it was not argued before and decided by the district court.

Tauber contends that his interpretation of the Treasury Amendment is supported by *Board of Trade v. Securities Exchange Commission,* 677 F.2d 1137 (7th Cir. 1982), *vacated as moot,* 459 U.S. 1026 (1982). Although he recognizes that the decision was vacated as moot because of a subsequently adopted amendment to the Act, Tauber argues that the holding is still authoritative on construction of the CEA. Two other cases relied upon by Tauber are *Chicago Mercantile Exchange v. Securities Exchange Commission,* 883 F.2d 537, 544 (7th Cir. 1989), *cert. denied,* 496 U.S. 936 (1990), and *CFTC v. American Board of Trade, Inc.,* 803 F.2d 1242 (2d Cir. 1986). At bottom, Tauber contends that these cases distinguish the statutory language of the Treasury Amendment, "transactions *in,*" from "transactions *involving*" foreign currency, assigning the former phrase only to transactions in which physical delivery of the commodity itself is anticipated. Tauber's position is supported by the Commodities Futures Trading Commission, which submitted a brief as an amicus curiae. *See also* SEC-CFTC Jurisdictional Correspondence [1975-1977 transfer binder] Comm. Fut. L. Rep. (CCH) ¶ 20,117, at 20, 831-41 (CFTC Staff Response Dec. 3, 1975).

Tauber also points to portions of the legislative history that show that Congress intended to exempt only transactions conducted among members of an international network of banks and dealers which trade in foreign currencies. *See, e.g.,* H.R. Conf. Rep. No. 1383, 93d Cong. 2d Sess. 35 (1974); S. Rep. No. 1131, *supra* at 6, 23, 31. He contends that in all of the explanations about the Act contained in the legislative history, no reference is found which suggests that futures and options involving foreign currency were being exempted from regulation. Finally, Tauber argues that if the Treasury Amendment is construed to apply to futures, it applies only to banks and financial institutions that engage in such transactions among themselves.

Salomon Forex characterizes this case as a standard breach of contract action involving privately negotiated futures and options contracts of the kind entered into daily by foreign currency dealers and banks. Contracts of this kind are routinely the basis for trading in foreign currencies and are, it contends, exempt from CEA regulation by reason of the Treasury Amendment adopted in 1974 pursuant to the Treasury Department's proposal. Salomon Forex argues that the Treasury Amendment is a broadly-worded exemption, bringing with in its scope all types of "off-exchange" arrangements for dealing in foreign currencies, including futures and options contracts. Arguing from the plain meaning of the Amendment and using other statutory interpretation tools, Salomon Forex asserts that Congress intended to leave unregulated all transactions conducted off exchanges "in which foreign currency *is the actual subject matter.*" As does Tauber, Salomon Forex relies on the legislative history and agency interpretation to support its position.

We are thus presented with the question of whether the individually negotiated, off-exchange futures and options contracts between Salomon Forex and Tauber involving foreign currencies are regulated by the CEA.

The *amici curiae* argue, for various reasons, that the answer to this question will have far-reaching effects. The Commodity Futures Trading Commission states that an interpretation which leaves these transactions unregulated frustrates the regulatory scheme developed by Congress over a period of 70 years "to secure the economic benefits of price discovery while protecting against the evils of price manipulation, excessive speculation, and boiler rooms which harm commerce and the public." Such an interpretation, the CFTC argues, would permit any individual to participate in futures contracts involving foreign currency, and "bucket shops and boiler rooms, the very type of fraudulent businesses Congress sought to outlaw in enacting the CEA, would inevitably follow." The

Board of Trade of the City of Chicago and Chicago Mercantile Exchange support the veiws of the Commission and add that such an interpretation would "threaten the commercial viability of the [commodity] exchanges." The State of Idaho, Department of Finance, and the Nevada Securities Division of the Office of the Secretary of State argue that if we adopt the interpretation advanced by Salomon Forex, the regulation of transactions of the kind here involved would probably be subject to regulation by the Securities Exchange Commission, a result not intended by Congress.

The United States in its *amicus curiae* brief urges that if we interpret the CEA to regulate the traditionally unregulated markets, market efficiency would be reduced and innovation in the development of new mechanisms would be inhibited, all with the tendency to increase the cost of financing government debt. The Securities Exchange Commission joins in the position of the United States. The Foreign Exchange Committee, which includes representatives of major domestic and foreign commercial and investment banks and foreign currency brokers, contends with great alarm that regulation of the United States portion of the foreign currency markets "would result in extra-ordinary costs and would damage the United States' ability to compete as a world financial center." They contend that regulation would adversely affect the large and developing global market in foreign currency forwards and options in which the 1989 average daily turnover approximated $50 billion. The Futures Industry Association, Inc. and the Managed Futures Association contend similarly that regulation of off-exchange transactions in foreign currencies "poses a potential threat to the continuing, smooth functioning" of the market.

IV

Interpretations of the Treasury Amendment have varied with the role of the interpreter. The Commodity Futures Trading Commission, pressing for greater regulation of

transactions in foreign currencies, contends that the Treasury Amendment's exemption is intended to be narrowly tailored to exclude only spot and cash forward transactions, leaving all other futures and options to be regulated by the broad inclusive regulatory language of the Act. Foreign currency traders and the United States contend that off-exchange trades must not be burdened by regulation, and the plain meaning of the Treasury Amendment expressly so provides. At bottom, however, we are left solely with the task of determining what *Congress* intended.

The analysis begins, as with the interpretation of any legislative enactment, with the language of the Act, and if that conclusively reveals Congress' intent, the analysis ends. In arriving at the plain meaning, we apply long recognized principles of interpretation. We assume that the legislature used words that meant what it intended; that all words had a purpose and were meant to be read consistently; and that the statute's true meaning provides a rational response to the relevant situation. Conversely, we presume that language added by amendment was not mere surplusage; that undefined terms mean no more than the language imports; and that a statute is not self-contradictory or otherwise irrational. The interpretive process is thus a holistic endeavor to derive intent from statutory language and structure.

Turning to the language at issue, the CEA excludes from its regulation "transactions in foreign currency" unless they involve sales "for future delivery conducted on a board of trade." 7 U.S.C. § 2. We must decide whether "transactions in foreign currency" includes futures and options of the type traded in by Salomon Forex and Tauber. The phrase "transactions in foreign currency" is broad and unqualified. Its breadth is confirmed by the "unless" clause which removes from "transactions in foreign currency" those transactions which are "for future delivery conducted on a board of trade." If Congress meant for the clause "transactions in foreign cur-

rency" to apply only to transactions in the commodity itself, it would have no reason to exclude futures transactions conducted on an exchange. The class of transactions covered by the general clause "transactions in foreign currency" must include a larger class than those removed from it by the "unless" clause in order to give the latter clause meaning. Thus, because the clause "unless such transactions involve the sale thereof for future delivery conducted on a board of trade" refers to futures, the general clause "transactions in foreign currency" must also include futures. Under this analysis, we would have to construe the Treasury Amendment exempting transactions in foreign currency to reach beyond transactions in the commodity itself and to include *all* transactions in which foreign currency is the subject matter, including futures and options.

A similar analysis in a larger context leads to the same result. The CEA and its predecessor Acts dating back to 1921 have always regulated only futures and options and never spot transactions or cash forwards. From the beginning the CEA has excluded cash forward transactions with the following language: "the term 'future delivery,' as used in this chapter, shall not include any sale of any cash commodity for deferred shipment or delivery." 7 U.S.C. § 2. Thus in 1974, when the Treasury Amendment was enacted, if Congress intended to limit the Amendment to spots and cash forwards in foreign currencies, as argued by Tauber, no amendment would have been necessary. All concede that these transactions were already excluded before the Treasury Amendment was adopted. The Treasury Amendment can only have meaning if it is interpreted to exclude something more than that which was already excluded before it was enacted.

In order to maintain that the clause "transactions in foreign currency" applies only to spots and cash forwards, as Tauber argues, we would also need to read in some

qualifying language. While it is rational to argue that "transactions in foreign currency" is different from "transactions *in contracts* for foreign currency," when that distinction is applied to actual transactions, the reasoning falters. For instance, while transactions that involve contemporary delivery of the commodity might be a transaction "in" the commodity, why would a cash forward be analytically different from a future? Neither transaction involves contemporaneous delivery. Both transactions involve the purchase of a promise—a contract right—and only indirectly concern the underlying subject matter. Moreover, in practice, cash forwards are often offset by other transactions in a manner similar to the way futures are traded. *See, Statutory Interpretation Concerning Forward Transactions*, 55 Fed. Reg. 39188, 39191-92 (Sept. 25, 1990).

Finally, the language of the Treasury Amendment excluding "transactions in" the subject goods is used elsewhere in the Act to mean all transactions *involving* the commodity. *See, e.g.*, 7 U.S.C. § 5 ("*Transactions in commodities* involving the sale thereof for future delivery as commonly conducted on boards of trade and known as 'futures' are affected with a national public interest." (emphasis added)).

Once we conclude that the clause is to be read broadly to include futures, it is a short step to conclude that the Treasury Amendment applies to *all* transactions in which foreign currencies are the subject matter, including options. Since trading in both futures and options involves foreign currency, albeit indirectly, there is no principled reason to distinguish between them in this context.

We are thus satisfied that under the appropriate interpretation of the Treasury Amendment, all off-exchange transactions in foreign currency, including futures and options, are exempted from regulation by the CEA.

That Congress intended the Treasury Amendment be taken at its word is confirmed by the Amendment's legis-

lative history. The uniformly expressed legislative intent behind the Treasury Amendment confirms that "transactions in foreign currency" are not limited to forwards. The concern that led to the adoption of the Treasury Amendment was that the informal network of established dealers in foreign currency-based investments would otherwise be brought within the ambit of the CEA. S. Rep. No. 1131 at 49-51, *reprinted in* 1974 U.S.C.C.A.N. at 5887-89. As the Senate report stated regarding the Agriculture and Forestry Committee's adoption of the Treasury Amendment:

> [T]he Committee included an amendment to clarify that the provisions of the bill are not applicable to trading in foreign currency and certain enumerated financial instruments unless such trading is carried out on a formally organized futures exchange. A great deal of the trading in foreign currency in the United States is carried out through an informal network of banks and tellers.[6] The Committee believes that this market is more properly supervised by the bank regulatory agencies and that, therefore, regulation under this legislation is unnecessary.

Id. at 19, *reprinted in* 1974 U.S.C.C.A.N. at 5863. Moreover, it was clearly understood that this off-exchange network of banks and dealers engaged in the very type of futures transactions that are involved in this case. When the 1974 amendments to the CEA were first proposed, the Treasury Department wrote the appropriate Senate committee, "The Department feels strongly that foreign exchange *futures trading*, other than on organized exchanges, should not be regulated by the new agency" (emphasis added). It proposed an amendment to accomplish that wish which Congress adopted virtually verbatim (excluding from the proposed amendment only

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[6] So in the original. "Traders" rather than "tellers" would seem to have been intended, from the context.

"puts and calls for securities" because they were covered by the securities laws). This Treasury request and direct congressional response is revealing.

To accept Tauber's reading of the Treasury Amendment would be to ignore the Amendment's plain meaning, legislative history, and context. It would also likely result in substantial market disruptions. The United States, advising this court as an *amicus curiae*, describes the significant disruption of the when-issued market for Treasury securities that would result if we were to adopt such an unnaturally restricted reading. The Foreign Exchange Committee in its *amicus* brief has also detailed the vast reach of the over-the-counter transactions which would be affected by an expansion of the CEA by this court.

We thus read the Treasury Amendment to apply to futures and options, and not solely to forwards. Tauber argues that such a reading is not fatal to his case, however, relying upon the alternative claim that even if some trading in foreign currency forwards and options is excluded, the exclusion applies only to trading carried out between banks. In making this argument, Tauber relies upon the references to protection of the "interbank market" found in the Treasury Amendment's legislative history, principally in the letter proposing the Amendment, and the references to bank regulation found in the Amendment's statutory history.

The Treasury letter does in fact refer to protection of the interbank market in foreign exchange futures. S. Rep. No. 1131, at 49-51, *reprinted in* 1974 U.S.C.C.A.N. at 5887-88. It notes, however, that this market is comprised of "an informal network of banks *and dealers.*" *Id.* at 5887 (emphasis added). The Treasury Department's concern was that CFTC regulation would "have an adverse impact on the usefulness and efficiency of foreign exchange markets *for traders and investors.*" *Id.* at 5888 (emphasis added). The Treasury Department, in pro-

posing and drafting the Treasury Amendment, did not draw a distinction between banks and professional traders; it drew a distinction between the "informal network of banks and dealers" intended to be excluded and "the participants on organized exchanges." *Id.* The trading between Tauber and Salomon Forex clearly falls into the former, not the latter, category, leaving Tauber's argument that the Treasury Amendment is restricted to trading between banks unsupported by the Amendment's legislative history.

More important than the lack of historical support for Tauber's alternative position is the absence of any such distinction in the statutory text. The statute distinguishes only between on-exchange and off-exchange trading. Under the statutory scheme, it is the nature of the trade (whether a standardized trade within an organized market or an individually negotiated private deal), not the corporate form of the trader that determines whether a trade is within the Act.

If the congressional goal underlying adoption of the Treasury Amendment was protection of the interbank market in foreign exchange forwards, this could have been accomplished easily by statutory language aimed at exempting only transactions in which both buyer and seller were banks. What the statute commands instead is the exemption of all trading off organized exchanges, including the entire informal professional trading network of which banks are a key part. As the trading between Salomon Forex and Tauber consisted of large-scale, customized, negotiated, bilateral transactions between sophisticated financial professionals, it falls within this classification and is not included within CEA coverage.

Tauber finally relies heavily on decisions of the Second and Seventh Circuits in defending his position, arguing that affirmance of the district court would result in a split among the circuits. The decisions to which Tauber cites

do not conflict with the outcome we reach today, however, as both cases concerned *on-exchange* trading on behalf of the general public, not individual, large-scale deals between professionals.

In *Commodity Futures Trading Comm'n v. American Bd. of Trade, Inc.*, 803 F.2d 1242 (2d Cir. 1986), the Second Circuit upheld the closing of an exchange which the Commodity Futures Trading Commission had not approved. The defendant in that case, the American Board of Trade ("ABT"), acted as an exchange for options on various commodities, including foreign currency. The CFTC sued because the ABT was not properly registered, and the district court enjoined further trading and ordered recompense of all monetary losses suffered by customers. The ABT appealed, claiming, *inter alia*, that the Treasury Amendment excluded its transactions in options on foreign currency from CEA regulation. The Second Circuit affirmed the district court. Although the court, in dictum, seemed to indicate that no trading in foreign currency options or futures is excluded from CEA coverage because such trading is not trading "in" foreign currencies, at the same time it noted that such trading *is* excluded when carried out by sophisticated financial institutions. *Id.* at 1248-49. This inconsistency reveals that the key factor for the Second Circuit in deciding the case was not the subject matter of the deals—options and futures in foreign currency—but the identity of the parties—unsophisticated private individuals buying on an organized exchange.

The Seventh Circuit faced a similar situation in *Board of Trade v. S.E.C.*, 677 F.2d 1137 (7th Cir.), *vacated as moot* 459 U.S. 1026 (1982). In this case, the Securities and Exchange Commission had authorized a formally organized exchange trading in options on Government National Mortgage Association mortgage-backed pass through certificates (GNMA's or Ginnie Maes). The Seventh Circuit held that exchange trading of such in-

struments fell within the CEA and concluded that the CFTC, not the SEC, had authority over such trading. Again, no off-exchange trading was involved.

Tauber argues that affirmance of the district court will result in the use of this circuit as a base for marketing off-exchange futures contracts to the general public. In doing so he misapprehends the issue which this case presents. This case does not involve mass marketing to small investors, which would appear to require trading through an exchange, and our holding in no way implies that such marketing is exempt from the CEA. *Cf. Commodity Futures Trading Commission v. Standard Forex, Inc.*, —— F. Supp. ——, slip op. at p. 25 (E.D.N.Y. 1993) (holding that Treasury Amendment excludes off-exchange transactions among banks already regulated and not transactions on a board of trade with "private unsophisticated investors"). The parties here agree that the transactions between Salomon Forex and Tauber were off-exchange transactions individually negotiated, and it is amply demonstrated that Tauber is a sophisticated investor. We hold only that individually-negotiated foreign currency option and futures transactions between sophisticated, large-scale foreign currency traders fall within the Treasury Amendment's exclusion from CEA coverage. They are "transactions in foreign currency . . . [that do not] involve the sale thereof for future delivery conducted on a board of trade." Tauber was, thus, not engaged in trading on an unregulated exchange, but was rather engaged in off-exchange trading of the sort exempted from coverage of the CEA by the Treasury Amendment.

V

Tauber argues that even if the CEA is not applicable, enforcement of his debt on summary judgment was inappropriate for other reasons. He contends that (1) his debt resulted from transactions violative of state law; (2) Salomon Forex was negligent in its handling of his

account, resulting in a viable counterclaim; and (3) Salomon Forex breached an oral "best pricing" covenant in its dealings with him. We find these additional arguments to be without merit.

Tauber argues that the transactions he engaged in with Salomon Forex were illegal under New York's bucket shop statute, 23 N.Y. Gen. Bus. Law § 351, and that the resulting debt is therefore unenforceable. It is, however, an element of a violation of § 351 that the offending contract be made "without intending a bona fide purchase or sale" of the subject matter and with the intent to settle the account by reference to market quotations. The agreements between Salomon Forex and Tauber were bona fide contracts, resulting in legal obligatons to take delivery. They were not settled by reference to the dealings of others, but by further trading between the parties, who engaged in offsetting transactions. The New York statute does not ban legally enforceable trades settled by further transactions, but only sham transactions. As the Supreme Court noted more than eight decades ago in finding that offsetting transactions did not render futures sales violative of the Illinois bucket shop law:

> It seems to us an extraordinary and unlikely proposition that the dealings which give its character to the great market for futures sales in this country are to be regarded as mere wagers or as "pretended" buying or selling . . . . A set-off is in legal effect a delivery.

Board of Trade of the City of Chicago v. Christie Grain & Stock Co., 198 U.S. 236, 249 (1905).

Tauber also asserts a counterclaim for negligence on the part of Salomon Forex, but is unable to cite sufficient evidence to create a triable issue of fact on this matter. In particular, Tauber has presented no evidence of any damages from the negligence alleged. In agreeing to trade with Tauber, Salomon Forex required that Tauber

post collateral to cover potential losses from sudden movements in currency markets. The amount of collateral required was keyed to Tauber's total exposure and was recalculated (by computer) as this fluctuated. In October 1989, Salomon announced that it had miscalculated Tauber's exposure to loss and that rather than having an excess of $15 million in collateral on deposit, Tauber had a deficit of $10 million. Tauber sent several letters to Salomon acknowledging that his exposure was now correctly calculated and promising to provide additional collateral. He expressly agreed to terms for providing this collateral, but failed to follow through on them.

Although Tauber did not cover this shortfall in collateral, the parties continued trading until March 1991, when Tauber's trading position became sharply negative as a result of a fall in the value of the Swiss franc, and Salomon Forex refused to continue trading without additional collateral. The only evidence offered linking Tauber's 1991 losses to the 1989 recalculation of required collateral is a single statement made at his deposition:

> I protested [the change in collateral required], but I could not do anything because I was locked in that position and my argument was always from day one that if it would be an American option, then I understood it, but in a European option, you cannot exercise that option any other day than the day of expiration.

This uncorroborated and unelaborated allegation of damage is insufficient to bear Tauber's burden of coming forward with evidence of the existence of a factual controversy as to liability. It identifies no duty that was breached and ignored Tauber's contractual undertakings when engaging in these transactions.

Finally, Tauber claims to have been damaged by Salomon Forex's breach of an alleged oral agreement to

provide him the "best price" on foreign currency options and futures. No evidence of the existence of such an agreement has been presented, leaving it without power to bar summary judgment. The sole support cited by Tauber as evidence of the existence of such an agreement is his own statement in an affidavit that:

> In 1987, Geraldine McManus, then an employee of Salomon, solicited my foreign currency trading. She represented at that time that Salomon was a leader in the world capital markets, that it could offer the best pricing on foreign currency instruments, the best market information, and the best execution of foreign currency market trades.

Based upon this allegation, Tauber argues that he had reached an oral agreement with Salomon Forex that they would offer him only the best price and that this agreement was later breached. Accepting Tauber's statement as true, as we must in reviewing the grant against him of summary judgment, it still does not establish any such "best-pricing" agreement. Further, all trades between Salomon and Tauber were confirmed in writing, and the confirmations provided that any objection be made in writing within 10 days. Tauber signed and returned the majority of these confirmations, although they did not include any "best pricing" clause, and never objected to the terms of the contracts.

VI

Tauber owes Salomon Forex the $26 million amount as a result of speculation on options and futures in foreign currencies. While Tauber claims his transactions with Salomon Forex are unenforceable because they did not comply with the CEA, the Treasury Amendment to the CEA, in exempting off-exchange transactions "in foreign currency," exempts off-exchange sales of options and futures in foreign exchange from CEA regulation. The trading between Salomon Forex and Tauber was off-

exchange, involving individually negotiated deals between sophisticated traders, and was therefore excluded from CEA coverage by the Treasury Amendment. Tauber's argument that his trading with Salomon Forex was illegal under state law prohibiting bucket shops is equally ineffective because his trading involved legally enforceable futures and option contracts, not sham transactions. Finally, there is no bona fide dispute as to the amount of Tauber's indebtedness or the existence of any counterclaim to its enforcement. The judgment entered in favor of Salomon Forex is, therefore, affirmed.

AFFIRMED

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

Civil No. 91-1415-A

SALOMON FOREX INC.,
Plaintiff,

v.

LASZLO N. TAUBER,
Defendant.

LASZLO N. TAUBER, M.D.,
Counter-Plaintiff and
Third-Party Plaintiff,

v.

SALOMON FOREX INC.,
Counter-Defendant,

v.

SALOMON BROTHERS INC., *et al.*,
Third-Party Defendants.

MEMORANDUM OPINION

[Filed June 1, 1992]

INTRODUCTION

This case presents a significant question concerning the scope of the Commodity Exchange Act, as amended, 7 U.S.C. §§ 1 *et seq.* (1980 & Supp. 1992) ("CEA"). At issue specifically is whether certain foreign currency trading contracts are exempt from CEA regulation.

Salomon Forex Inc. ("Salomon Forex"), a foreign currency brokerage company, sued Dr. Laszlo Tauber, an individual foreign currency trader, for breach of sixty-eight foreign currency trading contracts. Tauber filed a counterclaim against Salomon Forex and certain third-party defendants [1] challenging the validity of over 2700 foreign currency trading contracts, including the sixty-eight disputed in the complaint. A host of issues came before the Court on the parties' motions for summary and partial summary judgment. Addressed here is the threshold question, novel in this circuit and others, whether the foreign currency transactions into which Salomon Forex and Tauber entered are exempt from CEA regulation. For the reasons elaborated below, the Court concludes that the foreign currency contracts at issue are not within the scope of the CEA. The consequence of this is that counterclaims and defenses to contract formation and enforceability based on CEA violations fail.[2]

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[1] The third-party defendants are Salomon Brothers, Inc., Salomon, Inc., and Fred Gatling, Vice President of Salomon Brothers, Inc. Paul Mozer, head of the foreign exchange desk for Salomon Forex from 1990 to 1991 an original third-party defendant, was dismissed from the case for lack of personal jurisdiction.

[2] A number of other defenses and counterclaims were also raised by the pleadings and disposed of by the Court on summary judgment, leading to a grant of summary judgment in favor of Salomon Forex for $25,831,453.01, plus pre-judgment interest at the Virginia statutory rate. Among the issues involved in these other defenses and counterclaims were allegations of common law and statutory fraud, violations of state "bucketing" and gambling laws, negligence, breach of fiduciary duty, duress, failure to mitigate

FACTS

Salomon Forex is a prominent foreign currency trading company with offices in New York, London, Tokyo, and the world's principal foreign exchange markets. Tauber, a general surgeon practicing in Northern Virginia, is by all accounts an unusual person. The record indicates that he is a physician with an active medical practice who is also a major real estate investor [3] and foreign currency trader. It is the latter incarnation that is relevant here. Evidence suggests his net worth exceeds half a billion dollars.

Since 1981, Tauber has engaged in extensive foreign currency trading involving billions of dollars worth of foreign currency, primarily Swiss francs and Australian dollars. Over the years, Tauber has traded large quantities of foreign currency with at least fourteen well-known brokerage companies. In addition, Tauber traded foreign currency through his wholly-owned foreign currency trading company, Westwood Options, Inc., holder of a seat on the Philadelphia Stock Exchange, the nation's largest foreign currency exchange. To facilitate his foreign currency trading, Tauber subscribed to "Telerate," a computerized Dow-Jones service providing current market quotations and related data. Using Telerate, Tauber monitored foreign currency markets from computer terminals in his home and elsewhere. Tauber also maintained foreign bank accounts, which he used on several occasions to effectuate foreign currency transactions. And Tauber occasionally used foreign currency mortgages in connection with his real estate holdings. Notwithstanding Tauber's

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damages, estoppel, waiver, statute of frauds violations, breach of an implied covenant of good faith and fair dealing, breach of an express warranty of "best pricing," and breach of a duty to disclose material information relating to purported market manipulation.

[3] Included among Tauber's real estate interests across the country is a seventy-five percent share in Laszlo N. Tauber & Associates, which is one of the federal government's largest private landlords.

self-serving assertions to the contrary, the record evidence persuasively establishes that Tauber was a sophisticated foreign currency trader during the time relevant to this action.

Tauber engaged in foreign currency transactions with Salomon Forex from 1987 to 1991. He was Salomon Forex's only non-institutional client during this period. Salomon Forex's complaint arises over sixty-eight foreign currency futures [4] and options contracts that matured, and in the case of the options, were exercised in July and August of 1991. Tauber's counterclaim concerns 1,260 foreign currency futures contracts and 1,442 foreign currency options contracts. None of the contracts involved in the complaint or the counterclaim were executed on a board of trade or a formally organized exchange.[5] They were, in other words, conducted "off-exchange." [6]

A futures contract is a contract for the purchase or sale on a specific date in the future (the "trade date") of a specified amount of foreign currency at an agreed value. When the trade date arrives, the parties are obligated to consummate the transaction by delivery or receipt of the currency at the agreed price. Tauber and Salomon Forex both acted as buyers and sellers in their futures contracts. Frequently, they arranged off-setting transactions involv-

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[4] This nomenclature, used throughout this memorandum opinion, does not reflect any decision by the Court that these contracts were "futures" rather than "cash forwards" contracts for purposes of determining whether they might be exempt from the CEA under the "cash forwards contracts" exemption. *See* 7 U.S.C. §§ 2, 6(a). Given the result reached here, that issue need not be decided and is left for another day.

[5] Under the CEA, a "board of trade" is "any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling commodity or receiving the same for sale on consignment." 7 U.S.C. § 2.

[6] Tauber's course of dealing with Salomon Forex was not unusual in this regard. Much of his trading with other major brokerage firms also occurred off-exchange.

ing exactly the same amount of foreign currency in lieu of actual delivery or receipt of currency. The precise form of the set-off varied depending on market conditions, the investment strategies of the parties, and the like. The futures contract inured to the benefit of the buyer if the agreed price turned out to be lower than the market price on the trade date and to the seller if the agreed price was higher.

Options contracts function differently. In an options contract, one party pays the other a fee for the right—or option—to purchase or sell a specific amount of foreign currency on a future date certain at an agreed price. At various times during the course of their dealings, both Tauber and Salomon Forex held purchase or sale options offered by the other. If on the agreed date the transaction benefitted the option holder, the option holder exercised it, and the offering party was then obligated to purchase or sell foreign currency as specified in the contract. Usually, but not always, Tauber supplanted actual delivery or receipt of the foreign currency with an offsetting transaction.[7] If exercising the option would not be advantageous, the option holder did nothing and merely sacrificed the amount of the fee.

Tauber generally provided collateral, usually consisting of letters of credit or secured interests in other assets, for the foreign currency contracts made with Salomon Forex. In the event Tauber was unable to meet his contractual obligations, due to an inability to pay for currency he was obligated to purchase or to provide currency he was obligated to sell, Salomon Forex could look to the collateral to cover the resulting indebtedness. This case stems in part from Tauber's failure to post adequate security.

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[7] The record shows that on at least four occasions Tauber took actual delivery of foreign currency.

Specifically, by letter dated September 10, 1990, Tauber acknowledged his exposure to Salomon Forex to be approximately $24 million. He promised to provide additional security. By letter agreement dated February 21, 1991, the parties agreed to interim measures to protect Salomon Forex against losses incurred as a result of Tauber's foreign currency trading. These arrangements were to continue until August 31, 1991. Tauber failed to comply with the terms of this letter agreement, as well as with subsequent written and oral agreements to post additional collateral made as late as May 1991. Thus, when $25,831,453.01 became due and payable by Tauber under the sixty-eight contracts that matured in July and August 1991, Salomon Forex was inadequately secured. This lawsuit ensued.

ANALYSIS

The threshold issue raised by the parties' motions is whether the disputed foreign currency contracts violated the CEA. If so, the contracts would be unenforceable as a matter of law, and the controversy would cease in so far as the enforceability of the contracts is concerned. If, on the other hand, the contracts did not violate the CEA, the Court would then need to consider defendants' other defenses to contract formation and enforceability. For the purposes of this case, divining whether the contracts violated the CEA entails two steps. First is the question whether the contracts are exempt from the CEA under the so-called "Treasury Amendment," 7 U.S.C. § 2. If so, the inquiry under the CEA ends. If not exempt, the second question is whether the contracts are exempt under any other CEA provision apart from the Treasury Amendment.[8]

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[8] Given the dispositive result here of the first step, the Court did not reach this second step. Salomon Forex argued two additional statutory exemptions. First, it asserted that the futures contracts were exempt under the "cash forwards contracts" exemption. *See* 7 U.S.C. §§ 2, 6a. Second, it claimed that the options

Congress enacted the CEA, as amended, 7 U.S.C. §§ 1 *et seq.* (1980 & Supp. 1992), to combat excessive speculation and price manipulation in commodity trading involving future delivery as commonly conducted on a board of trade. *See* 7 U.S.C. § 5. The CEA established the Commodity Futures Trading Commission (the "CFTC"), *see* 7 U.S.C. § 4a, and empowered it to regulate commodity trading for future delivery conducted on boards of trade in accordance with the regulatory scheme embodied in the statute. *See* 7 U.S.C. §§ 1 *et seq.* *See generally Statutory Interpretation Regarding Trading in Foreign Currencies For Future Delivery,* 50 Fed. Reg. 42983, [1984-86 Transfer Binder] Comm. Fut. Law Rep. ¶ 22,750, at 31,121 (Oct. 23, 1985) (the "CFTC Statement"). Prior to 1974, the CEA governed only certain enumerated, generally agricultural commodities. *See* 7 U.S.C. § 2 (1970). Over the years, Congress modified and expanded the CEA's definition of "commodity". Significantly, in 1974, Congress enlarged the definition effectively to include foreign currency and other financial instruments.[9] *See* Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974) (codified as amended at 7 U.S.C. § 2). The resulting definition of "commodity" is encyclopedic:

> The word "commodity" shall mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums,

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contracts were exempt under the "trade options" exemption. *See* 7 U.S.C. §§ 6c(b) and (d). Without deciding these issues, the Court notes, *obiter,* that disposition of these claims likely would require resolution of disputed material issues of fact, thereby precluding summary judgment.

[9] Among other changes, the 1974 amendments augmented the previously enumerated commodities with the phrase: "all other goods and articles, . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." *See* Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974) (codified as amended at 7 U.S.C. § 2).

> mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13-1 of this title, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in . . . .

7 U.S.C. § 2. Thus, virtually every conceivable good, article, right, or interest—except onions [10]—is potentially a commodity within the meaning of the CEA. Given this, it is undisputed and indisputable that foreign currency may be a commodity for purposes of the CEA.

Prior to enactment of the 1974 amendments, the Treasury Department became concerned that the proposed expansion of CFTC jurisdiction would adversely impact existing off-exchange markets for foreign currency and certain other financial instruments. Accordingly, the Department proposed an exemption for off-exchange transactions for future delivery in foreign currency and certain enumerated financial instruments. *See* S. Rep. No. 1131, 93rd Cong., 2d Sess. 49-51 (1974) (reprinting letter dated July 30, 1974, from the General Counsel of

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[10] Trading in onion futures is prohibited, 7 U.S.C. § 13-1(a). This provision brought tears to the eyes of at least some would-be onion futures traders. *See Chicago Mercantile Exchange v. Tieken*, 178 F. Supp. 779 (D.C. Ill. 1959) (finding that a rational basis existed for Congress' conclusion that the speculative aspect of plaintiff's business in onion futures trading caused severe and unwarranted fluctuations in cash price of onions to the detriment of onion producers and the orderly flow of onions in interstate commerce, and accordingly holding that the statute was within the scope of congressional authority over interstate commerce and did not violate due process). Violating this statute is a misdemeanor punishable by a $5,000 fine. 7 U.S.C. § 13-1(b).

the Treasury to the Chairman of the Senate Committee on Agriculture and Forestry) (the "Treasury Letter"). The Treasury Letter listed several reasons for exempting off-exchange transactions for future delivery in foreign currency and certain other financial instruments. These reasons included (i) the existence of an already-regulated interbank market, (ii) the capacity of existing regulatory entities, namely the Comptroller of the Currency and the Federal Reserve, to regulate these transactions, (iii) lack of expertise of the CFTC in regulating complex banking functions, and (iv) the potential for "an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors." Treasury Letter at 50.

With one exception not relevant here, Congress adopted the Treasury Department's proposed provision, enacting what is now commonly called the "Treasury Amendment." [11] *See* Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974) (codified as amended at 7 U.S.C. § 2). The Treasury Amendment states, in pertinent part: "Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency . . ., unless such transactions involve the sale thereof for future delivery conducted on a board of trade." [12] 7 U.S.C. § 2. Although the transactions in this case involved sales for future delivery, none was conducted on a board of trade. *Cf. Abrams v. Oppenheimer Government Securities, Inc.*, 589 F. Supp. 4, 7 (N.D. Ill. 1983) (holding that the

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[11] Congress deleted "puts and calls for securities" from the list of exempted transactions proposed by the Treasury Department. *Compare* 7 U.S.C. § 2 *with* Treasury Letter at 51.

[12] The provision reads in full: "Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. § 2.

Treasury Amendment applied (and hence the CEA did not) to a contract for Government National Mortgage Association securities because it was not executed through an organized exchange). This being so, the disputed contracts are exempt from the CEA if they constitute "transactions in foreign currency." The central question presented then is the meaning and scope of this statutory phrase.

The touchstone of statutory interpretation is legislative intent as expressed in the statute's words. Thus, the well-settled starting point in the interpretive inquiry is the language of the statute itself. *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 1030 (1989); *Matala v. Consolidated Coal Co.*, 647 F.2d 427, 429 (4th Cir. 1981) (stating the basic principles of statutory interpretation and applying them to § 203(b)(3) of the Federal Coal Mine Health and Safety Act of 1964). *See also Buckeye Production Credit Association v. Farm Credit Administration*, —— F. Supp. ——, —— n.18, 1992 W.L. 57606, 10 n.18 (E.D. Va. 1992) (noting, in interpreting the Farm Credit Act, that "the best and most reliable indication of legislative intent is the statutory language itself"). Where the terms of a statute are unambiguous, the judicial inquiry is complete, except "in rare and exceptional circumstances." *See Rubin v. United States*, 449 U.S. 424, 430, 101 S.Ct. 698, 701 (1981) (quoting *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 187 n.33, 98 S.Ct. 2279, 2298 n.33 (1978)). *See also Ron Pair Enterprises*, 489 U.S. at 242, 109 S.Ct. at 1031 (plain meaning of legislation conclusive except in rare circumstances where literal application of a statute would lead to a result demonstrably at odds with congressional intent); *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571, 102 S.Ct. 3245, 3250 (1982) (same); *In re Forfeiture Hearings as to Caplin & Drysdale, Chartered*, 837 F.2d 637, 641 (4th Cir. 1988) (where a statute's language is unambiguous, court's task of statutory construction ends unless enforcement of

statutory language would contravene clearly expressed legislative intent); *Hoechst Aktiengesellschaft v. Quigg*, 917 F.2d 522, 526 (Fed. Cir. 1990) (same). The plain meaning of a statute should be rejected only if there is substantial, unambiguous evidence supporting a contrary interpretation. *Matala*, 647 F.2d at 430. *See also Ford Motor Credit Co. v. Cenance*, 452 U.S. 155, 158 n.3, 101 S.Ct. 2239, 2241 n.3 (1981) ("Absent a clear indication of legislative intent to the contrary, the statutory language controls its construction."). For purposes of statutory interpretation, words of a statute are presumed to be used according to their ordinary meaning unless a different use is clearly indicated. *See Matala*, 647 F.2d at 429.

Applied here, these well-established principles of statutory interpretation compellingly point to the conclusion that the foreign currency contracts between Tauber and Salomon Forex are covered by the Treasury Amendment and thus excluded from regulation under the CEA. Simply put, in the CEA context, the phrase "transactions in foreign currency" plainly and unambiguously means any transaction, without limitation as to the participants involved, in which foreign currency is the commodity or subject matter, much as one would speak of transactions in flaxseed or wool tops. This clear statutory language gives rise to no lurking ambiguities. Given this, the judicial inquiry properly ceases here without resort to legislative history. *See Ron Pair Enterprises*, 489 U.S. at 242, 109 S.Ct. at 1031; *Griffin*, 458 U.S. at 571, 102 S.Ct. at 3250; *Rubin*, 449 U.S. at 430, 101 S.Ct. at 701; *Caplin & Drysdale*, 837 F.2d at 641; *Hoechst Aktiengesellschaft*, 917 F.2d at 526.

But in any event, the CEA's legislative history discloses no clear, unambiguous basis for concluding, as Tauber insists, that "transactions in foreign currency" contains a limitation on the transactional participants. Specifically, Tauber contends that the Treasury Amendment exempts

only those transactions between financial institutions, that is, the "interbank" market. Tauber argues, by selective references, that the legislative history reveals a congressional intent to restrict the scope of the exemption to the interbank market.[13] Tauber's position fails in two respects. First, the Treasury Amendment's plain language is not qualified in any respect to limit the covered participants. And legislative history may not be invoked to create an ambiguity where none otherwise exists. *See Railroad Comm'n of Wisconsin v. Chicago, Burlington and Quincy R.R. Co.*, 257 U.S. 563, 589, 42 S.Ct. 232, 238 (1922) (legislative history admissible to solve doubt, not create it); *Matala*, 647 F.2d at 430 ("The legislative history should never be used to create doubt if the language of a statute is plain on its face.") (citations omitted). Second, even if resorting to legislative history were appropriate, nothing contained therein indicates congressional intent to exclude *only* the interbank market. That Congress may have expressed concern about a particular circumstance, or reacted to Treasury Department concern about a particular circumstance, does not, by itself, demonstrate that Congress intended to address only that circumstance. Indeed, other portions of the legislative history suggest that the Treasury Department sought, and Congress intended, a broad exemption for off-

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[13] *See* S. Rep. No. 1131, 93rd Cong., 2d Sess. 6 (1974) ("the *Committee* amendment provides that inter-bank trading of foreign currencies and specified financial instruments is not subject to Commission regulation") (emphasis in original); S. Rep. No. 1194, 93rd Cong., 2d Sess. 35 (1974) ("the *Senate* amendment provides that interbank trading of foreign currencies and specified financial instruments is not subject to Commission regulation") (emphasis in original); Treasury Letter at 49-51 (discussing concern that CFTC jurisdiction not extend to the regulation of off-exchange transactions conducted by financial institutions and observing that "virtually all futures trading in foreign currencies in the United States is carried out through an informal network of banks and dealers. . . . The participants in this market are sophisticated and informed institutions, unlike the participants on *organized* exchanges . . . .") (emphasis in original).

exchange transactions for future delivery in foreign currency and certain enumerated financial instruments.[14] Taken as a whole, the legislative history reveals no clear and unambiguous expression of legislative intent to restrict the Treasury Amendment to the interbank market sufficient to warrant rejecting the plain, unambiguous, ordinary meaning of the statutory language. *See Ford Motor Credit Co*, 452 U.S. at 158 n.3, 101 S.Ct. at 2241 n.3; *Matala*, 647 F.2d at 429-30. Especially instructive here is *Bank Brussels Lambert, S.A. v. Intermetals Corp.*, 779 F. Supp. 741, 751 (S.D.N.Y. 1991). Presented there with an essentially similar argument, that court reviewed legislative history and held that the Treasury Amendment is not limited to the interbank market in cases of spot trading of foreign currency. In so doing, the court concluded that "even if it is correct that Con-

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[14] *See* S. Rep. No. 1131, 93rd Cong., 2d Sess. 23, 31 (1974) ("the Committee included an amendment to clarify that the provisions of the bill are not applicable to trading in foreign currencies and certain enumerated financial instruments unless such trading is conducted on a formally organized futures exchange. A great deal of the trading in foreign currency in the United States is carried out through an informal network or banks and tellers. The Committee believes that this market is more properly supervised by the bank regulatory agencies and that, therefore, regulation under this legislation is unnecessary." and "transactions in foreign currency, security warrants and rights, resales of installment loan contracts, repurchase options, government securities or mortgages and mortgage purchase commitments would not be subject to the Act unless they involve the sale thereof for future delivery conducted on a board of trade."); Treasury Letter at 49-50, 51 ("The Department feels strongly that foreign currency futures trading, other than on organized exchanges, should not be regulated by the new agency;" "[w]here the need for regulation of transactions on other than organized exchanges does exist, this should be done through strengthening existing regulatory responsibilities not lodged in the Comptroller of the Currency and the Federal Reserve;" and "we strongly urge the Committee to amend the proposed legislation to make clear that its provisions would not be applicable to futures trading in foreign currencies or other financial transactions of the nature described above other than on organized exchanges.").

gress' *motivation* . . . was to exempt interbank trading . . . statutory history of this nature cannot be a substitute for express terms of the statute." (emphasis in original).[15]

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[15] The CFTC statutory interpretation relied on by Tauber to establish the interbank market limitation is unpersuasive. There, the CFTC opined:

> Solely as a result of these expressions of concern by the [Treasury] Department [the Treasury Letter], and only for the purpose of addressing these specific concerns, Congress adopted, virtually without change, a provision recommended by the Treasury . . . and which is generally referred to as the "Treasury Amendment." Insofar as foreign currency transactions were concerned, Congress expressed its intention that the Treasury Amendment be limited in its application to the interbank trading of such transactions supervised by the banking agencies. *See* S. Rep. No. 1131, 93rd Cong., 2d Sess. 6, 23, 31 (1974); S. Rep. No. 1194, 93rd Cong., 2d Sess. 35 (1974).

CFTC Statement at 31,122. The CFTC concluded that the Treasury Amendment does not apply to off-exchange foreign currency transactions involving members of the general public and solicited written comments concerning that nature and identity of the "sophisticated and informed institutions" comprising the interbank market. CFTC Statement at 31,125.

The CFTC's reasoning here is flawed. Congress may well have adopted the Treasury Amendment to address the specific concerns of the Treasury Department, but those concerns, as expressed in the Treasury Letter, were not limited to protecting the interbank market. Moreover, as noted above, the statutory language, on its face, does not express any intention to limit application of the Treasury Amendment to the interbank market. Nor can the legislative history cited by the CFTC reasonably be viewed as standing for the proposition that Congress intended to exempt only the interbank market. *See supra* notes 13, 14 and accompanying text. Simply put, the CFTC, in an apparent effort to maximize its jurisdictional reach, overreaches any reasonable interpretation attributable to the statutory language or legislative history.

This CFTC misinterpretation underscores the difficulty inherent in divining legislative intent from legislative history and reaffirms the sensible and well-settled principle that the plain language of a statute is conclusive absent substantial, unambiguous evidence supporting a contrary interpretation. *See Ford Motor Credit Co.*, 452 U.S. at 158 n.3, 101 S.Ct. at 2241 n.3; *Matala*, 647 F.2d at 430. As this Court has elsewhere noted, legislative history is frequently

Tauber also claims that the word "in" in the phrase "transactions in foreign currency" is ambiguous, at least with respect to the options contracts. Specifically, Tauber contends that the options contracts are not transactions "in" foreign currency. Rather, he asserts that they are transactions "in" rights to exercise options that merely "involve" foreign currency. While this may have some semantical appeal, once the option is exercised and the foreign currency traded or exchanged, the transaction, even by Tauber's lights, becomes one "in" foreign currency under the plain language of the Treasury Amendment. *Accord Commodity Futures Trading Comm'n v. American Board of Trade*, 803 F.2d 1242, 1248 (2nd Cir. 1986) (permitting CFTC to enjoin public offerings of options to trade in foreign currency because "an option transaction giving the option holder the right to purchase foreign currency by a specified date and at a specified price does not become a 'transaction[] in' that currency unless and until the option is exercised.").[16] Here, the option contracts between Tauber and Salomon Forex were exercised when they matured in July and August of 1991. Thus, the exercised options contracts became transactions "in" foreign currency exempt from regulation under the CEA.

That the bulk of the contracts ultimately resulted in off-setting transactions, rather than actual receipt or de-

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an unreliable indicator of legislative intent. *See Buckeye*, —— F. Supp. at —— n.18, 1992 W.L. 57606, 10. *See generally* Note, *Why Learned Hand Would Never Consult Legislative History Today*, 105 Harv. L. Rev. 1005 (1992).

[16] *See also Board of Trade of City of Chicago v. S.E.C.*, 677 F.2d 1137, 1154 (7th Cir.), *vacated as moot*, 459 U.S. 1026, 103 S.Ct. 434 (1982) (finding), in the context of Government National Mortgage Association options, that "the options market may exist without any transactions in the commodity itself" and that a GNMA option is a transaction "in" government securities under the Treasury Amendment "[o]nly when the option holder exercises the option."). The reasons for the mootness of this opinion are unstated.

livery of foreign currency, does not alter this result. A set-off is, in legal effect, a delivery. *See Board of Trade v. Christie Grain & Stock Co.*, 198 U.S. 236, 248, 25 S.Ct. 637, 639 (1905) (Holmes, J.). Under the exercised options contracts, the parties had the obligation and capacity to deliver or accept delivery of the specified foreign currency at the set prices on the fixed dates. Put another way, upon exercising the option, the option holder had the immediate and absolute legal right to insist that the foreign currency be delivered. That the parties elected for commercial convenience, necessity, or other reasons to forgo actual delivery in favor of entering into new, separate, off-setting contracts is of no legal consequence with respect to the delivery obligation under the original contract. That original legal obligation to make or take delivery makes the exercised options, in sum and substance, "transactions in foreign currency." *Cf. In re Bybee*, 945 F.2d 309 (9th Cir. 1991) (deferring, in the context of a dispute over the "cash forwards contracts" exemption, to the CFTC view that subsequent off-setting contracts do not impair contractual delivery obligations).[17]

In essence, the Court finds the Treasury Amendment is unmistakably clear and unambiguous on its face. All transactions in which foreign currency is the actual sub-

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[17] The CFTC language followed by the Ninth Circuit reads:

> [that] while such [offset] agreements may extinguish a party's delivery obligation, they are separate, individually negotiated, new agreements, there is no obligation or arrangement to enter into such agreements, they are not provided for by the terms of the contracts as initially entered into, and any party that is in a position in a distribution chain that provides for the opportunity to book-out [offset] with another party or parties in the chain is nevertheless entitled to require delivery of the commodity to be made through it, as required under the contracts.

Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. 39188, 39189 (Sept. 15, 1990).

ject matter of an off-exchange contract for future delivery are exempt from the CEA. Further judicial inquiry is not required. To the extent that Congress may have intended a more restrictive exemption, it could easily have so stated. In any event, a search of the legislative history discloses no substantial, unambiguous evidence supporting a more restrictive interpretation. That Congress intended to accommodate the Treasury Department's concerns as expressed in the Treasury Letter is reasonably clear. That Congress intended to exclude off-exchange transactions in foreign currency for future delivery conducted by the interbank market from CFTC regulation is pellucidly clear. Yet this purpose is not at odds with the plain and ordinary language of the statutory provision as enacted. Nothing in the legislative history suggests unambiguously that Congress intended to exempt *only* the interbank market. Nor does the result reached here frustrate any clearly expressed legislative intent. *See Ron Pair Enterprises,* 489 U.S. at 242, 109 S.Ct. at 1031; *Griffin,* 458 U.S. at 571, 102 S.Ct. at 3250; *Caplin & Drysdale,* 837 F.2d at 641; *Hoeschst Aktiengesellschaft,* 917 F.2d at 526. Having determined, therefore, that the Treasury Amendment excludes the disputed contracts from the CEA, the Court need not, and does not, consider whether the contracts are also exempt under any other CEA provision.[18]

CONCLUSION

In sum, the Court holds that the foreign currency futures and options contracts between Tauber and Salomon Forex are not subject to regulation under the CEA because they were off-exchange "transactions in foreign currency" for future delivery within the purview of the Treasury Amendment. Thus, nothing in the CEA bars their enforcement.

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[18] Also left for another day is the question of the appropriate measure of damages for CEA violations. *See* 7 U.S.C. § 25.

An appropriate Order has issued with respect to this holding and other matters addressed from the bench.

/s/ T. S. Ellis, III
T. S. Ellis, III
United States District Judge

Alexandria, Virginia
June 1, 1992

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

Civil No. 91-1415-A

SALOMON FOREX INC.,
Plaintiff,

v.

LASZLO N. TAUBER,
Defendant.

LASZLO N. TAUBER, M.D.,
Counter-Plaintiff and
Third Party Plaintiff,

v.

SALOMON FOREX INC.,
Counter-Defendant,

v.

SALOMON BROTHERS INC., *et al.*,
Third Party Defendants.

ORDER

This matter comes before the Court on plaintiff's and third-party defendants' Motion for Summary Judgment and defendant's Motion for Partial Summary Judgment.

For the reasons stated from the bench,[1] the Court concludes that:

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[1] These reasons will be amplified in part in a forthcoming memorandum opinion.

1. Plaintiff's and third-party defendants' Motion for Summary Judgment on the complaint and the counterclaim third-party complaint should be, and hereby is, GRANTED in favor of plaintiff on (i) the issue of liability under count 1 of the complaint (ii) and all claims of the counterclaim/third-party complaint.

2. Defendant's Motion for Partial Summary Judgment on Counts 1 and 2 of the counterclaim should be, and hereby is, DENIED.

3. Accordingly, all claims of the counterclaim/third-party complaint should be, and hereby are DISMISSED against plaintiff and the third-party defendants WITH PREJUDICE.

4. Plaintiff's and third-party defendants' counterclaim in reply should be, and hereby is, DISMISSED WITH PREJUDICE.

On the issue of the appropriate amount of damages under count 1 of the complaint, defendant asserts that a triable issue of fact remains with respect to his defense of breach of contract based on allegations of price-gouging by plaintiff.[2] Specifically, defendant contends that plaintiff breached an express representation of "best pricing" made by one of plaintiff's sales persons by overcharging him for the options and futures he purchased. In support of this defense, defendant presents expert testimony that concludes, based on the application of generally recognized and accepted economic analysis and testing procedures, that plaintiff overcharged defendant in excess of $18 million.

Although the Court finds that a dispute of fact may exist with respect to whether the prices charged by plain-

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[2] Whether this claim was properly presented as a breach of contract claim is questionable. To the extent that this claim sounds in fraud, the Court rejects it for the reasons stated from the bench.

tiff were the "best price," it nevertheless concludes that this dispute is not material here because defendant cannot establish that the contracts contained express representations of best pricing. Plaintiff sent defendant written confirmations following each of the sixty-eight transactions at issue. These written confirmations provided that defendant would be deemed to have accepted the terms and conditions contained within them unless written objections were made within ten days of their receipt. Defendant confirmed by signature fifty-six of the confirmations. No written objections were made to any of the contracts. The written confirmations did not include any express representation of best pricing. Under the Uniform Commercial Code, as adopted by both Virginia and New York, a written confirmation, even unsigned, is binding on a merchant unless objected to in writing within ten days. *See* U.C.C. § 2-201(2). Defendant qualifies as a merchant for purposes of § 2-201(2). *See* U.C.C. § 2-204; *Armco, Inc. v. New Horizon Dev. Co. of Virginia,* 331 S.E.2d 456 (Va. 1985) (a merchant is "a business professional as opposed to a casual or inexperienced seller or buyer"). Consequently, defendant cannot use parol evidence to add new or contradictory terms to the final expression of the parties' agreements as embodied in the written confirmations. *See* U.C.C. § 2-202; *Intershoe v. Bankers Trust,* 571 N.E.2d 641, 644 (N.Y. 1991) (holding in a foreign currency transaction with a shoe manufacturer that the written confirmation slip constituted the final expression of the parties' agreement and could not be impeached by parol evidence of contradictory terms); *Armco,* 331 S.E.2d at 456 (unobjected to written confirmation for sale of pipe a final expression of the parties' agreement). Accordingly, the Court concludes that no legal basis exists for defendant's defense of breach of express representations of best pricing.

For the above-stated reasons and for the reasons stated from the bench, the Court concludes that summary judg-

ment on the issue of damages should be, and hereby is, GRANTED in favor of plaintiff in the amount of $25,-831,453.01 plus prejudgment interest calculated at the Virginia statutory rate.

Plaintiff is DIRECTED (i) to prepare a sketch of a judgment order setting forth the amounts of damages and prejudgment interest and (ii) to provide defendant with a reasonable opportunity to review the sketch of the order as to form. The form of judgment order is to be submitted to the Court no later than 5:00 p.m., Friday, March 27, 1992.

The Clerk is directed to remove this case from the trial docket.

The Clerk is also directed to send copies of this Order to all counsel of record.

/s/ T. S. Ellis, III
T. S. Ellis, III
United States District Judge

Alexandria, Virginia
March 24, 1992

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

Civil Action No. 91-1415-A

SALOMON FOREX INC.,
Plaintiff,

v.

LASZLO N. TAUBER, M.D.,
Defendant.

LASZLO N. TAUBER, M.D.,
Counter-Plaintiff and
Third-Party Plaintiff,

v.

SALOMON FOREX INC.,
Counter-Defendant,

v.

SALOMON BROTHERS INC., *et al.*,
Third-Party Defendants.

JUDGMENT ORDER

[Filed March 27, 1992]

In accordance with this Court's Order of March 24, 1992, granting the Motion for Summary Judgment of plaintiff and the third-party defendants, and denying de-

fendant's Motion for Partial Summary Judgment, it is hereby ORDERED AND ADJUDGED:

1. Judgment is hereby entered for plaintiff and against defendant in the amount of $27,266,587.80 (comprising principal amounts due plaintiff of $25,831,453.01 plus prejudgment interest of $1,435,134.79 at nine percent per annum pursuant to Virginia Code § 6.1-330.54). The judgment shall bear interest at the rate of nine percent per annum, or $6,723.27 per diem, pursuant to Virginia Code § 6.1-330.54.

2. Plaintiff shall recover its costs in accordance with Local Rule 16.

The Clerk is directed to send copies of this Judgment Order to all counsel of record.

/s/ T. S. Ellis, III
T. S. ELLIS, III
United States District Judge

Alexandria, Virginia
March 27, 1992

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

C/A 91-1415-A

SALOMON FOREX INC.,
Plaintiff,

vs.

LASZLO N. TAUBER, M.D., *et al.*,
Defendants.

TRANSCRIPT OF PROCEEDINGS
March 24, 1992

CROSS-MOTIONS FOR SUMMARY JUDGMENT

Before: THE HONORABLE T.S. ELLIS, III, Presiding
United States District Court Judge

* * * *

[52] The central issue, as I noted, is whether the Treasury Amendment—that is, 7 United States Code, Section 2—applies in this instance to exclude the transactions from the Commodities Exchange Act. That really is the, the threshold, central issue, because if it does not exclude these matters and they are covered by the Commodities Exchange Act, then there is a substantial additional amount of analysis, as to which we did not take much oral argument. We did have some oral argument on it, but I think even that oral argument which was had on it —I think Mr. Tuohey makes a good point—there are factual issues that are disputed. If it's necessary, if the Treasury Amendment does not exempt the futures, contracts and regulations, was the Commodities Exchange Act violated or does the exception for cash-forward contracts apply: that issue would probably involve factual issues. Further, if the Treasury Amendment doesn't exempt the options and contracts from regulations under the Commodities Exchange Act, the question is whether Section 4c, subsection (c) of the Act that bans option trading except on designated exchanges, was that violated or is there a trade options exception applicable here. That, too, probably involves triable issues of fact, although the Court did not and does [53] not reach those. And if the Commodities Exchange Act was violated, there is further the problem of damages.

Now, the central issue is what is the meaning of 7 United States Code, Section 2, which provides that: Nothing in this chapter—that is, the Commodities Exchange Act—shall be deemed to govern or in any way be applicable to transactions in foreign currency—some omissions—unless such actions involve the sale thereof for future delivery conducted on a board of trade.

So the question is were the 68 contracts transactions, were any of these contracts or options transactions in foreign currency.

It is clear that the most pertinent authority on this is the Second Circuit's decision in the *American Board of*

Trade case, where the court there found that an option transaction giving the option holder the right to purchase foreign currency by a specified date and at a specified price does not become a transaction in that currency unless and until the option was exercised. And where it is exercised, however, then, under the *American Board of Trade* case, they would be within the exception.

Tauber relies on that case. Salomon Forex says that it's distinguishable in terms of result on three grounds: first, that they were in fact exercised, thereby bringing them within the purview of the exceptions; [54] secondly, that it doesn't apply because it's wrongly decided in that it invokes, really, a metaphysical distinction between "transactions in" and "transactions involving;" and thirdly, that it's factually inapposite because the case involved a Commission injunctive action against an exchange.

The Court concludes that while there may be distinctions in *American Board of Trade*, the essential holding is correct. And the Court further concludes that the—in this instance, the Court concludes that the transactions here, the contracts here, are transactions in foreign currency. They were, in effect, exercised. The fact that there were setoffs, the Court is persuaded that Justice Holmes had it right in the *Christie* case, that a setoff is, in legal effect, a delivery. In addition, as the record reflects, on four occasions, that Tauber actually took delivery. So an offset transaction, in the Court's view, amounts to a delivery since the parties had the obligation and the capacity to deliver on the contracts.

Having concluded that, it is unnecessary to proceed to consider whether the speculative purpose for the transaction makes it more likely to be a nonexempt futures contract and, for example, whether the Sections 4c(c) and 4c(d) of the Commodities Exchange Act make the contracts [55] unlawful and so forth, as I outlined earlier.

And on this issue, which I think is fairly novel, the Court may, as soon as it is able consistent with other

cases, including a lengthy jury trial which is shortly to begin, prepare a memorandum opinion to supplement the findings that the Court has made from the bench.

* * * *

[59] * * * But really, I think the central focus given the parties' briefs, I have dealt with. I will [60] probably prepare a memorandum on the applicability of the Commodities Exchange Act and the Treasury exception.

In essence, I am persuaded by the plaintiff's position that stems from the plain language of the amendment and which, in essence, says that if folks want to deal off exchange trading in currencies, the Commodities Exchange Act does not apply. It doesn't matter whether it's an individual or an institution or what the nature of the entity is.

* * * *

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 92-1406
CA-91-1415-A

SALOMON FOREX, INCORPORATED,
Plaintiff-Appellee

v.

LASZLO N. TAUBER, M.D.,
Defendant
& Third Party
Plaintiff-Appellant

and

LASZLO N. TAUBER M.D. AND ASSOCIATES,
Defendant

v.

SALOMON BROTHERS, INCORPORATED;
SALOMON, INCORPORATED; FRED GATLING,
Third Party Defendants-Appellees

and

PAUL MOZER,
Third Party Defendant

THE BOARD OF TRADE OF THE CITY OF CHICAGO; CHICAGO MERCANTILE EXCHANGE; UNITED STATES OF AMERICA; FUTURES INDUSTRY ASSOCIATION, INCORPORATED; MANAGED FUTURES ASSOCIATION,
Amici Curiae

FOREIGN EXCHANGE COMMITTEE,
Amicus Curiae

COMMODITY FUTURES TRADING COMMISSION; STATE OF IDAHO, Department of Finance; NEVADA SECURITIES DIVISION OF THE OFFICE OF THE SECRETARY OF STATE,
Amici Curiae

ON PETITION FOR REHEARING WITH SUGGESTION FOR REHEARING IN BANC

[FILED November 17, 1993]

The appellant's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

FOR THE COURT

/s/ Bert M. Montague
Clerk

APPENDIX G

STATUTORY PROVISIONS

Pertinent portions of the Commodity Exchange Act (CEA), as amended, include the following*:

7 U.S.C. § 1a (Section 1a of the CEA):

As used in this chapter:

(1) Board of trade

The term "board of trade" means any exchange or association, whether incorporated or unincorporated, of persons who are engaged in the business of buying or selling any commodity or receiving the same for sale on consignment.

* * * *

(3) Commodity

The term "commodity" means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13-1 of this title, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.

* * * *

(*) A codification mistake in 7 U.S.C.A. (Supp. 1993) was corrected in the May 1993 Pamphlet Number 1 for U.S.C.A.

(11) Future delivery

The term "future delivery" does not include any sale of any cash commodity for deferred shipment or delivery.

7 U.S.C. § 2 (Section 2(a)(1)(A) of the CEA):

(i) The Commission shall have exclusive jurisdiction, except to the extent otherwise provided in section 2a of this title, with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title. Except as hereinabove provided, nothing contained in this section shall (I) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (II) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State.

(ii) Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

* * * *

7 U.S.C. § 5 (Section 3 of the CEA):

> Transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest. Such futures transactions are carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the products and byproducts thereof in interstate commerce. The prices involved in such transactions are generally quoted and disseminated throughout the United States and in foreign countries as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof and to facilitate the movements thereof in interstate commerce. Such transactions are utilized by shippers, dealers, millers, and others engaged in handling commodities and the products and byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price. The transactions and prices of commodities on such boards of trade are susceptible to excessive speculation and can be manipulated, controlled, cornered or squeezed, to the detriment of the producer or the consumer and the persons handling commodities and the products and byproducts thereof in interstate commerce, rendering regulation imperative for the protection of such commerce and the national public interest therein. Furthermore, transactions which are of the character of, or are commonly known to the trade as, "options" are or may be utilized by commercial and other entities for risk shifting and other purposes. Options transactions are in interstate commerce or affect such commerce and the national economy, rendering regulation of such transactions imperative for the protection of such commerce and the national public interest.

7 U.S.C. § 6 (Section 4 of the CEA):

(a) Restriction of futures trading to contract markets

Unless exempted by the Commission pursuant to subsection (c) of this section, it shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) unless—

(1) such transaction is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a "contract market" for such commodity;

(2) such contract is executed or consummated by or through a member of such contract market; and

(3) such contract is evidenced by a record in writing which shows the date, the parties to such contract and their addresses, the property covered and its price, and the terms of delivery: *Provided*, that each contract market member shall keep such record for a period of three years from the date thereof, or for a longer period if the Commission shall so direct, which record shall at all times be open to the inspection of any representative of the Commission or the Department of Justice.

* * * *

(c) Exemption

(1) In order to promote responsible economic or financial innovation and fair competition, the Commission by rule, regulation, or order, after notice and opportunity for hearing, may (on its own initiative or on application of any person, including any board of trade designated as a contract market for transactions for future delivery in any commodity under section 7 of this title) exempt any agreement, contract, or transaction (or class thereof) that is otherwise subject to subsection (a) of this section (including any person or class of persons offering, entering into, rendering advice or rendering other services with respect to, the agreement, contract, or transaction), either unconditionally or on stated terms or conditions or for stated periods and either retroactively or prospectively, or both, from any of the requirements of subsection (a) of this section, or from any other provision of this chapter (except section 2(a) of this title), if the Commission determines that the exemption would be consistent with the public interest.

(2) The Commission shall not grant any exemption under paragraph (1) from any of the requirements of subsection (a) of this section unless the Commission determines that—

(A) the requirement should not be applied to the agreement, contract, or transaction for which the exemption is sought and that the exemption would be consistent with the public interest and the purposes of this chaper; and

(B) the agreement, contract, or transaction—

(i) will be entered into solely between appropriate persons; and

(ii) will not have a material adverse effect on the ability of the Commission or

any contract market to discharge its regulatory or self-regulatory duties under this chapter.

(3) For purposes of this subsection, the term "appropriate person" shall be limited to the following persons or classes thereof:

(A) A bank or trust company (acting in an individual or fiduciary capacity).

(B) A savings association.

(C) An insurance company.

(D) An investment company subject to regulation under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.).

(E) A commodity pool formed or operated by a person subject to regulation under this chapter.

(F) A corporation, partnership, proprietorship, organization, trust, or other business entity with a net worth exceeding $1,000,000 or total assets exceeding $5,000,000, or the obligations of which under the agreement, contract or transaction are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by any such entity or by an entity referred to in subparagraph (A), (B), (C), (H), (I), or (K) of this paragraph.

(G) An employee benefit plan with assets exceeding $1,000,000, or whose investment decisions are made by a bank, trust company, insurance company, investment adviser registered under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.), or a commodity trading advisor subject to regulation under this chapter.

(H) Any governmental entity (including the United States, any state, or any foreign government) or political subdivision thereof, or any multinational or supranational entity or any instrumentality, agency, or department of any of the foregoing.

(I) A broker-dealer subject to regulation under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) acting on its own behalf or on behalf of another appropriate person.

(J) A futures commission merchant, floor broker, or floor trader subject to regulation under this chapter acting on its own behalf or on behalf of another appropriate person.

(K) Such other persons that the Commission determines to be appropriate in light of their financial or other qualifications, or the applicability of appropriate regulatory protections.

(4) During the pendency of an application for an order granting an exemption under paragraph (1), the Commission may limit the public availability of any information received from the applicant if the applicant submits a written request to limit disclosure contemporaneous with the application, and the Commission determines that—

(A) the information sought to be restricted constitutes a trade secret; or

(B) public disclosure of the information would result in material competitive harm to the applicant.

(5) The Commission may—

(A) promptly following the enactment of this subsection, or upon application by any person, exercise the exemptive authority granted under paragraph (1) with respect to classes of

hybrid instruments that are predominantly securities or depository instruments, to the extent that such instruments may be regarded as subject to the provisions of this chapter; or

(B) promptly following the enactment of this subsection, or upon application by any person, exercise the exemptive authority granted under paragraph (1) effective as of October 23, 1974, with respect to classes of swap agreements (as defined in section 101 of Title 11) that are not part of a fungible class of agreements that are standardized as to their material economic terms, to the extent that such agreements may be regarded as subject to the provisions of this chapter.

Any exemption pursuant to this paragraph shall be subject to such terms and conditions as the Commission shall determine to be appropriate pursuant to paragraph (1).

(d) Effect of exemption on authority of Commission

The granting of an exemption under this section shall not affect the authority of the Commission under any other provision of this chapter to conduct investigations in order to determine compliance with the requirements or conditions of such exemption or to take enforcement action for any violation of any provision of this chapter or any rule, regulation or order thereunder caused by the failure to comply with or satisfy such conditions or requirements.

* * * *

7 U.S.C. § 6c (Section 4c of the CEA):

* * * *

(b) Regulated option trading

No person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which

is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe. Any such order, rule, or regulation may be made only after notice and opportunity for hearing, and the Commission may set different terms and conditions for different markets.

* * * *

(f) Nonapplicability to foreign currency options

Nothing in this chapter shall be deemed to govern or in any way be applicable to any transaction in an option on foreign currency traded on a national securities exchange.

* * * *

7 U.S.C. § 6i (Section 4i of the CEA):

It shall be unlawful for any person to make any contract for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market—

> (1) if such person shall directly or indirectly make such contracts with respect to any commodity or any future of such commodity during any one day in an amount equal to or in excess of such amount as shall be fixed from time to time by the Commission, and
>
> (2) if such person shall directly or indirectly have or obtain a long or short position in any commodity or any future of such commodity equal to or in excess of such amount as shall be fixed from time to time by the Commission,

unless such person files or causes to be filed with the properly designated officer of the Commission such

reports regarding any transactions or positions described in clauses (1) and (2) hereof as the Commission may by rule or regulation require and unless, in accordance with rules and regulations of the Commission, such person shall keep books and records of all such transactions and positions and transactions and positions in any such commodity traded on or subject to the rules of any other board of trade, and of cash or spot transactions in, and inventories and purchase and sale commitments of such commodity. Such books and records shall show complete details concerning all such transactions, positions, inventories, and commitments, including the names and addresses of all persons having any interest therein, and shall be open at all times to inspection by any representative of the Commission or the Department of Justice. For the purposes of this section, the futures and cash or spot transactions and positions of any person shall include such transactions and positions of any persons directly or indirectly controlled by such person.

7 U.S.C. § 7 (Section 5 of the CEA):

The Commission is hereby authorized and directed to designate any board of trade as a "contract market" when, and only when, such board of trade complies with and carries out the following conditions and requirements:

(1) When located at a terminal market where any cash commodity of the kind specified in the contracts of sale of commodities for future delivery to be executed on such board is sold in sufficient volumes and under such conditions as fairly to reflect the general value of the commodity and the differences in value between the various grades of such commodity, and where there is available to such board of

trade, official inspection service approved by the Secretary of Agriculture or the Commission for the purpose: *Provided,* That any board of trade not so located shall be designated as a "contract market" if such board of trade provides for the delivery of commodities on such contracts at a delivery point or points and upon terms and conditions approved by the Commission.

(2) When the governing board thereof provides for the making and filing by the board or any member thereof, as the Commission may direct, of reports in accordance with the rules and regulations, and in such manner and form and at such times as may be prescribed by the Commission, showing the details and terms of all transactions entered into by the board, or the members thereof, either in cash transactions or transactions for future delivery consummated on or subject to the rules of a board of trade, and when such governing board provides, in accordance with such rules and regulations, for the keeping of a record by the board or the members of the board of trade, as the Commission may direct, showing the details and terms of all cash and future transactions entered into by them, consummated on or subject to the rules of a board of trade, such record to be in permanent form, showing the parties to all such transactions, including the persons for whom made, any assignments or transfers thereof, with the parties thereto, and the manner in which said transactions are fulfilled, discharged, or terminated. Such record shall be required to be kept for a period of three years from the date thereof, or for a longer period if the Commission shall so direct, and shall at all times be open to the inspection of any representative of

the Commission or United States Department of Justice.

(3) When the governing board thereof provides for the prevention of dissemination by the board or any member thereof of false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.

(4) When the governing board thereof provides for the prevention of manipulation of prices and the cornering of any commodity by the dealers or operators upon such board.

(5) When the governing board thereof does not exclude from membership in and all privileges on such board of trade any duly authorized representative of any lawfully formed and conducted cooperative association of producers having adequate financial responsibility which is engaged in any cash commodity business, if such association has complied, and agrees to comply, with such terms and conditions as are or may be imposed lawfully on other members of such board: *Provided,* That no rule of a contract market shall forbid or be construed to forbid the return on a patronage basis by such cooperative association to its bona fide members of moneys collected in excess of the expense of conducting the business of such association.

(6) When the governing board provides for making effective the final orders or decisions entered pursuant to the provisions of section 9 of this title, and the orders issued pursuant to the provisions of section 7a of this title, and for compliance in all other respects with the re-

quirements applicable to such board of trade under this chapter.

(7) When such board of trade demonstrates that transactions for future delivery in the commodity for which designation as a contract market is sought will not be contrary to the public interest.

(8) When such board of trade demonstrates that every contract market for which such board of trade is designated complies with the requirements of section 7a(b) of this title.

* * * *

7 U.S.C. § 9 (Section 6(c) of the CEA):

If the Commission has reason to believe that any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any contract market, or has willfully made any false or misleading statement of a material fact in any registration application or any report filed with the Commission under this chapter, or willfully omitted to state in any such application or report any material fact which is required to be stated therein, or otherwise is violating or has violated any of the provisions of this chapter or of the rules, regulations, or orders of the Commission thereunder, it may serve upon such person a complaint stating its charges in that respect, which complaint shall have attached or shall contain therein a notice of hearing, specifying a day and place not less than three days after the service thereof, requiring such person to show cause why an order should not be made prohibiting him from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice

of the Commission, and to show cause why the registration of such person, if registered with the Commission in any capacity, should not be suspended or revoked. Said hearing may be held in Washington, District of Columbia, or elsewhere, before the Commission, or before an Administrative Law Judge designated by the Commission, which Administrative Law Judge shall cause all evidence to be reduced to writing and forthwith transmit the same to the Commission. Upon evidence received, the Commission may (1) prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, (2) if such persons is registered with the Commission in any capacity, suspend, for a period not to exceed six months, or revoke, the registration of such person, (3) assess such person a civil penalty of not more than the higher of $100,000 or triple the monetary gain to such person for each such violation and (4) require restitution to customers of damages proximately caused by violations of such persons. Notice of such order shall be sent forthwith by registered mail or by certified mail or delivered to the offending person and to the governing boards of said contract markets. After the issuance of the order by the Commission, the person against whom it is issued may obtain a review of such order or such other equitable relief as to the court may seem just by filing in the United States court of appeals of the circuit in which the petitioner is doing business, or in the case of an order denying registration, the circuit in which the petitioner's principal place of business listed on petitioner's application for registration is located, a written petition, within fifteen days after the notice of such order is given to the offending person praying that the order of the Commission be set aside. A copy of

such petition shall be forthwith transmitted by the clerk of the court to the Commission and thereupon the Commission shall file in the court the record theretofore made, as provided in section 2112 of Title 28. Upon the filing of the petition the court shall have jurisdiction to affirm, to set aside, or modify the order of the Commission, and the findings of the Commission as to the facts, if supported by the weight of evidence, shall in like manner be conclusive.

7 U.S.C. § 13 (Section 9 of the CEA):

(a) It shall be a felony punishable by a fine of not more than $1,000,000 (or $500,000 in the case of a person who is an individual) or imprisonment for not more than five years, or both, together with the costs of prosecution, for:

* * * *

(2) Any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any contract market, or to corner or attempt to corner any such commodity or knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, or knowingly to violate the provisions of section 6 of this title, section 6b of this title, subsections (a) through (e) of subsection 6c of this title, section 6h of this title, section 6*o*(1) of this title, or section 23 of this title.

7 U.S.C. § 25 (Section 22 of the CEA):

(a)(1) Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person—

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of—

(i) an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

* * * *

Supreme Court
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MAR 17 1994
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No. 93-1314

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

LASZLO N. TAUBER, M.D.,
Petitioner,

v.

SALOMON FOREX INC, SALOMON INC, SALOMON BROTHERS INC, AND FRED GATLING,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

BRIEF FOR RESPONDENTS IN OPPOSITION

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March 17, 1994

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QUESTION PRESENTED

Respondents adopt the court of appeals' statement of the issue presented by this case (Pet. App. 2a):

"[W]hether professional traders may individually negotiate sales of foreign currency futures and options off organized exchanges without violating the Commodities Exchange Act" ("CEA") by reason of the "Treasury Amendment," which provides that "[n]othing in [the CEA] shall be deemed to govern or in any way be applicable to transactions in foreign currency, . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii).

RULE 29.1 LISTING

PARTIES TO THE PROCEEDING

The caption of the case contains the names of all parties.

Salomon Forex Inc is a wholly owned subsidiary of Salomon Brothers Holding Company Inc, which is itself a wholly owned subsidiary of Salomon Inc.

Salomon Brothers Inc is a wholly owned subsidiary of Salomon Brothers Holding Company Inc, which is itself a wholly owned subsidiary of Salomon Inc.

Salomon Inc is a publicly held corporation. For a full listing of Salomon Inc's subsidiaries, *see* p. 5a.

Fred Gatling is vice president of Salomon Brothers Inc.

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IN THE

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OCTOBER TERM, 1993

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LASZLO N. TAUBER, M.D.,
Petitioner,

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SALOMON FOREX INC, SALOMON INC,
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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

BRIEF FOR RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-26a) is reported at 8 F.3d 966. One of the opinions of the district court (Pet. App. 27a-44a) is reported at 795 F. Supp. 768.

JURISDICTION

The judgment of the court of appeals was entered on October 18, 1993. (Pet. App. 2a.) A timely petition for rehearing was denied on November 17, 1993. (Pet. App. 55a-56a.) The petition for a writ of certiorari was filed on February 15, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT

Petitioner mischaracterizes this case in four respects. *First*, it does *not* "involve[] *trading in* options and futures contracts." (Pet. 2, emphasis added.) The contracts here were never "traded"—either on an exchange or with other parties. The case actually involves options and futures contracts that were privately negotiated between petitioner and respondent, two professional foreign currency traders. Their transactions were part of the billions of dollars' worth of "off-exchange" foreign currency futures and options contracts that are negotiated every day among professional traders and dealers.

Second, the case does not present a question of "staggering" practical impact. (Pet. 14.) Far from "deregulat[ing]" any activity (Pet. 21), the decision below merely recognizes the lawfulness of the off-exchange futures and options contracts that professional traders have privately negotiated for many years. Indeed, petitioner asserted in the district court that "a ruling in this case affects only one person." (*See* n.10, *infra*.)

Third, there is no "wide divergence of views expressed by the federal government" as to the judgment below. (Pet. 17.) *All* federal agencies and departments rejected petitioner's interpretation of the Treasury Amendment, and *all* agreed that the facts of this case warranted affirmance of the district court's judgment for respondents.

Fourth, there is no conflict among circuits because, as the court of appeals observed, previous decisions address "*on exchange* trading on behalf of the general public, not individual, large-scale deals between professionals." (Pet. App. 21a.)

We are aware of no other case in which a party or agency has ever questioned the lawfulness under the CEA of foreign currency contracts negotiated privately between professional traders in off-exchange transactions. Petitioner, a long-time participant in off-exchange transac-

tions with respondent and many other firms, raised these issues for the first time in resisting payment of his contractual debt to respondents. The fact-bound application of settled principles by the courts below does not warrant further review.

A. Facts

Respondent Salomon Forex Inc, ("Salomon") is a foreign currency trading company with offices or affiliated operations in New York, London, Tokyo, and other leading foreign currency trading centers.[1] Petitioner Tauber is a prominent real estate investor and foreign currency trader whose net worth exceeds half a billion dollars. (Pet. App. 29a.)

Tauber has for many years engaged in foreign currency trading, both personally and through his wholly-owned trading company, Westwood Options, Inc. (which is a member of the nation's largest foreign currency option exchange.) (Pet. App. 3a, 29a.) During the past decade, he has personally engaged in billions of dollars' worth of off-exchange "futures" and option contracts not only with Salomon, but also with more than a dozen other leading foreign currency trading companies. (Pet. App. 3a.) These "off-exchange" contracts were not executed or traded on a board of trade or other organized exchange. (Pet. App. 30a, 35a.) Tauber pursued complex trading strategies, which included simultaneous "positions" with different trading firms that mutually limited the risk of one another. (*Id.*)

From 1989 to 1991, Tauber and Salomon negotiated more than 2700 off-exchange foreign currency "futures" and options contracts.[2] In the futures transactions, one

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[1] Respondents Salomon Brothers Inc, Salomon Inc, and Fred Gatling were third-party defendants in counterclaims filed by petitioner.

[2] Because the district court held that the contracts were excluded from CEA regulation by the Treasury Amendment, the court did

party promised to buy or sell a specified quantity of foreign currency at a certain price for delivery on a set date. In the options transactions, one party sold to the other for a cash fee the right (an "option") to buy ("call") or sell ("put") a specified quantity of foreign currency at a certain rate of exchange on an agreed-upon "exercise date." Each contract bound the parties to make or take delivery of currency. Although Tauber typically negotiated new, off-setting contracts to avoid the inconvenience of actually delivering or receiving foreign currency, he took delivery on at least four occasions. (Pet. App. 4a, 31a n.7.)

Salomon and Tauber negotiated the specific terms of every contract, usually in morning telephone calls. (Pet. App. 3a.) These contracts were a tiny part of the billions of dollars of off-exchange foreign currency futures and options transactions that are privately negotiated every day among professional foreign currency dealers and traders, banks, corporations, and governments.[3] This

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not reach Salomon's alternative arguments that the "futures" contracts were removed from CEA regulation under the statutory "cash forwards" exclusion for sales of "cash commodity for deferred shipment or delivery," *see* 7 U.S.C. §§ 1(a)(11), 6(a) and that the options were exempt "trade options," *see* 7 U.S.C. § 6c(b), (d).

Salomon and Tauber referred to their purchase-and-sale agreements as "forwards contracts." This is the term used in off-exchange markets for such transactions without regard to whether they would be classified as "futures" or "cash forwards" if they were subject to the CEA. *See, e.g., Abrams v. Oppenheimer Gov't Sec., Inc.*, 589 F. Supp. 4, 7 (N.D. Ill. 1983), *aff'd*, 737 F.2d 582, 590 (7th Cir. 1984). Here, we use the term "futures," as did the courts below, to refer to the contracts which the parties themselves called "forwards."

[3] *See, e.g.*, Federal Reserve Bank of New York, *Foreign Exchange Turnover Survey* (Sept. 13, 1989) (reporting $6.17 and $5.10 billion in average daily turnover in off-exchange foreign currency "forward contracts" and option contracts, respectively, in the United States). This and other surveys are discussed in the *amicus* brief of the Federal Reserve Bank of New York, Foreign Exchange Committee before the court of appeals. *See* Brief of the

round-the-clock, off-exchange market (sometimes called the "OTC," "interbank" or "interdealer" market) existed long before enactment of the CEA in 1974.[4] It affords participants the ability to negotiate contract terms suited to their individual needs and interests.

Privately-negotiated, off-exchange transactions are separate and distinct from the standardized foreign currency contracts that are traded "on-exchange," *i.e.*, on boards of trade and other regulated exchanges or contract markets.[5] Because on-exchange contracts have standardized terms (governing quantity, delivery, expiration date and credit support), they are readily tradable in secondary transactions regardless of the identity of the parties and they can be settled by automatic off-set or an exchange clearinghouse. Although the general public routinely participates in on-exchange trading, only sophisticated market professionals, backed by large assets, negotiate foreign currency futures and options in the off-exchange market.[6] The off-exchange market dwarfs the on-exchange

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Foreign Exchange Committee as *Amicus Curiae* in Support of Appellees at 10-12, *Tauber v. Salomon Forex Inc*, 8 F.3d 966 (4th Cir. 1993) (No. 92-1406) (hereinafter "Foreign Exchange Comm. *Amicus* Br.").

[4] In fact, the off-exchange foreign currency futures market dates to the 1870's. *See* Perkins, *The Emergence of a Futures Market in Foreign Exchange in the United States*, 11 Explorations in Economic History 193 (1974).

[5] For an overview of differences between on-exchange and off-exchange foreign currency transactions, see Committee on Futures Regulation, Association of the Bar of the City of New York, *The Evolving Regulatory Framework for Foreign Currency Trading* 13-17, 25-26 (Dec. 16, 1986) (hereinafter *Evolving Regulatory Framework*).

[6] *See* CFTC, *OTC Derivative Markets and Their Regulation* 124 (Oct. 1993) (hereinafter *1993 CFTC Report*). Salomon established a trading relationship with Tauber only after determining that he is an experienced foreign currency trader with an enormous net worth. (C.A. App. 81.) He is the only natural person with whom Salomon entered into foreign currency contracts. (Pet. App. 3a, 30a.)

market in the dollar volume of foreign currency futures and options transactions.

Salomon's individually-negotiated terms with Tauber required, among other things, that he maintain collateral to cover his potential losses. In September 1990, Tauber acknowledged his unsecured exposure to be approximately $24 million and promised to provide additional collateral. (Pet. App. 32a.) In succeeding months, the parties agreed to several interim measures to protect Salomon. Tauber did not comply with these agreements. (Pet. App. 32a.)

In July and August 1991, 68 foreign currency contracts came due under which Tauber owed Salomon $25.8 million. After he failed to honor his obligations, Salomon filed a one-count action for breach of contract in the United States District Court for the Eastern District of Virginia. Tauber responded with a myriad of defenses and counterclaims.[7] The only claim relevant here is his contention that his foreign currency contracts with Salomon were unenforceable because they were illegal under the CEA. Tauber had not previously asserted that position, nor (to our knowledge) has he questioned the lawfulness under the CEA of his contemporaneous off-exchange transactions (many profitable) with other foreign currency trading firms.

B. Statutory Background

The CEA regulates the trading of contracts for the purchase or sale of commodities for future delivery. *See* 7 U.S.C. §§ 1, *et seq.* The statute generally requires commodity futures and options trading to be conducted on a

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[7] Petitioner's 18 affirmative defenses and 11 counterclaims included allegations of fraud, unlawful "gambling," "bucketing," breach of fiduciary duty, duress, and breach of a duty to disclose material information relating to purported market manipulation. (Pet. App. 28a n.2.) In rejecting Tauber's claims, the district court characterized some of them as "ludicrous," "flatly silly," or inconsistent with his own admissions. (C.A. App. 21, 23, 24, 42.)

board of trade that is formally designated and regulated by the Commodity Futures Trading Commission ("CFTC") as an exchange or "contract market". *See* 7 U.S.C. §§ 6(a), 6c(b), *see also* 17 C.F.R. § 32.11(b).

Before 1974, the CEA regulated trading of futures in agricultural commodities. In that year, Congress enlarged the definition of "commodity" to include virtually all objects of futures trading, including foreign currency and other financial instruments. *See* Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974) (codified as amended at 7 U.S.C. § 2). The 1974 Act also created the CFTC to regulate commodity futures and options trading. During Congress' consideration of these 1974 amendments, the Treasury Department became concerned that the new definition of "commodity," and the scheme of CFTC regulation, would embrace (and adversely affect) the important off-exchange markets for foreign currency and other financial instruments.

Consequently, the Treasury Department sent a letter to Congress urging that specified classes of off-exchange transactions be excluded from the CEA's coverage (and hence from CFTC regulation).[8] (The letter is included in the Appendix at p. 1a.) With one exception not relevant here, Congress adopted verbatim the language of the Treasury Department's proposal, thus enacting what is known as the "Treasury Amendment:"

> "Nothing in this [Act] shall be deemed to govern or in any way be applicable to transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii).

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[8] *See* S. Rep. No. 1131, 93d Cong., 2d Sess. 49-51 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5843, 5887-89 (Letter from Acting General Counsel, Department of the Treasury, to Chairman, Senate Committee on Agriculture and Forestry (July 30, 1974)).

C. Proceedings Below

The district court rejected petitioner's defenses and counterclaims and granted summary judgment for Salomon. (Pet. App. 27a-44a.) In disposing of petitioner's "novel" CEA arguments (Pet. App. 28a), the district court relied on the plain language of the Treasury Amendment: "the foreign currency futures and options contracts between Tauber and Salomon Forex are not subject to regulation under the CEA because they were off-exchange 'transactions in foreign curency.'" (Pet. App. 43a.)

The court of appeals affirmed in a unanimous opinion. (Pet. App. 1a-26a.) It analyzed the ways in which the text, statutory context and legislative history of the Treasury Amendment manifested an intention to exclude from CEA regulation "all off-exchange transactions in foreign currency, including futures and options." (Pet. App. 17a.) The court of appeals then held that the foreign currency transactions between Salomon and Tauber plainly fell within the Treasury Amendment, because they were privately-negotiated and involved no offering to or participation by the general public of the sort characteristic of trading on an exchange.[9]

In rejecting the arguments of Tauber (and *Amici* commodity exchanges) that a ruling against him would allow unscrupulous dealers or "bucket shops" to ex-

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[9] Petitioner contended from the start of the litigation that the parties' contracts were entered off-exchange. He suggested for the first time in the court of appeals that Salomon might be deemed a "board of trade." The court of appeals declined to entertain that new theory. (Pet. App. 11a n.5.) The court of appeals' refusal to decide an issue never raised by petitioner in the district court is another strong reason why this case is *not* suited for further review. It should also be noted that both the CFTC and the Federal Reserve's Foreign Exchange Committee argued that Salomon was not a "board of trade" under accepted principles. (Brief for the CFTC as *Amicus Curiae* at 12-13, *Tauber v. Salomon Forex Inc*, 8 F.3d 966 (4th Cir. 1992) (No. 92-1406) (hereinafter "CFTC *Amicus* Br."); Foreign Exchange Comm. *Amicus* Br. at 27-29.) *See also Abrams*, 589 F. Supp. at 7.

ploit the general public, the court of appeals stressed that "[w]e hold only that individually-negotiated foreign currency options and futures transactions between sophisticated large-scale foreign currency traders"—such as the transactions at issue between Salomon and Tauber—"fall within the Treasury Amendment's exclusion from CEA coverage." (Pet. App. 22a.) Since the transactions in this case involved no trading with the general public, the parties were "not engaged in trading on an unregulated exchange, but . . . in off-exchange trading of the sort exempted from coverage of the CEA by the Treasury Amendment." *Id.* The court of appeals specifically rejected any broader reading of its holding, explaining that "[t]his case does not involve mass marketing to small investors, which would appear to require trading through an exchange, and our holding in no way implies that such marketing is exempt from the CEA." *Id.* (citation omitted).

REASONS FOR DENYING THE WRIT

Petitioner says that the Court should devote its limited resources to this case because the applicability of the Treasury Amendment to foreign currency futures and options is a question of "staggering" importance "on which the circuit courts, and the federal government itself, are deeply divided." (Pet. 14.) But the facts of this case do not support that claim.

No case of which we are aware has ever challenged the lawfulness under the CEA of privately-negotiated futures and options contracts between professional foreign currency traders. *Every* federal government *amicus* below disagreed with Tauber's interpretation of the Treasury Amendment and concurred that his transactions with Salomon were lawful. Tauber's petition seeks to obscure these points by focusing on cases involving the trading of standardized contracts with the general public by unregulated boards of trade.

I. THE FACTS OF THIS CASE DO NOT PRESENT THE BROAD QUESTION PRESSED BY PETITIONER

The court of appeals' holding is narrow and fact-bound. The court below ruled that, whatever the precise outer contours of the Treasury Amendment, it surely excludes from the CEA the particular foreign currency contracts here: "large-scale, customized, negotiated, bilateral transactions between sophisticated financial professionals." (Pet. App. 20a.) Indeed, petitioner himself stressed in the district court that "a ruling in this case affects only one person." [10]

The court of appeals' narrow holding does not present the broader issue that Tauber now asserts is of "staggering" importance: the extent to which the Treasury Amendment covers marketing of foreign currency futures and options contracts to the public outside regulated exchanges. Because this Court "reviews judgments, not statements in opinions," no further review of this case is warranted. *California* v. *Rooney*, 483 U.S. 307, 311 (1987) (per curiam) (internal quotation marks and citations omitted).

A. No Practical Consequences Warrant Review

There is no basis for Tauber's assertions that the decision below (i) "permits outright deregulation" of trading currently overseen by the CFTC (Pet. 21) and (ii) calls into question "whether trading must continue on regu-

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[10] Tauber's Memorandum in Support of Motion for Partial Summary Judgment at 12 (filed Feb. 28, 1992). Tauber contended that the Treasury Amendment did not apply to him as an individual because it only excluded from the CEA off-exchange contracts between institutional traders. *See also* Tauber's Reply to Salomon's Opposition; and In Support of His Own Motion for Partial Summary Judgment, at 2 (filed March 16, 1992): "The Treasury Amendment is a limited exception from the CEA's general exchange trading requirement . . . applicable only to banks and other financial institutions."

lated exchanges . . . for a tremendous volume of economic activity." (Pet. 13.) To the contrary, the off-exchange foreign currency market long predated the creation of the CFTC in 1974 and has continued side-by-side with the emerging trading of standardized contracts on the regulated exchanges.[11]

As both courts below found, the Treasury Amendment aimed to ensure that the important off-exchange market would continue unfettered by Congress' otherwise dramatic expansion of the CEA in 1974. (Pet. App. 17a-20a, 34a-36a).[12] Tauber's theory—not the decision below—would turn the existing regulatory situation upside down, by imposing new CFTC regulation on an off-exchange market that dwarfs on-exchange trading. Indeed, to eliminate any uncertainty caused by the *Tauber* litigation, the CFTC has issued rules confirming that privately-negotiated off-exchange foreign currency contracts among sophisticated traders are lawful.[13]

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[11] *See supra* note 4; *see also* Brief for the United States As *Amicus Curiae* at 4-8, *Tauber v. Salomon Forex Inc*, 8 F.3d 966 (4th Cir. 1992) (No. 92-1406) (hereinafter "United States *Amicus* Br."); *1993 CFTC Report* at 47-48.

[12] One study emphasizes that the off-exchange market

> "has expanded and evolved in response to changing business needs and circumstances to include investment banks, securities and commodities houses, pension funds, insurance companies, commodity pools, multinational corporations and sophisticated individuals, as well as its traditional commercial bank participants. Indeed, the Treasury Amendment was adopted, in part, to permit such growth and evolution to occur free from CFTC regulation." *Evolving Regulatory Framework* at 43.

[13] After the district court decision and briefing in the court of appeals, the CFTC (heeding statements of Congressional conferees) issued new regulations "to create legal certainty for a number of existing categories of instrument which trade today outside the forum of a designated contract market" as to which regulated exchange trading "may be unnecessary to protect the public interest and may create an inappropriate burden on commerce." 58 Fed.

It is implausible to assert that the decision below creates broad new opportunities for abusive, unregulated dealing in foreign currency futures and options. (Pet. 21-22). (The argument is also disingenuous, coming from a long-time professional trader in the established off-exchange market.) Participation in the off-exchange foreign currently market will continue to be limited to sophisticated and financially strong market participants such as banks and other institutional and professional traders.[14] There is no basis for concern that the judgment here will unleash marketing "by boileroom 'telemarketers' to unsophisticated members of the general public."

Reg. 5587, 5588 n.10 (1993), citing H.R. Rep. No. 978, 102d Cong., 2d Sess. 80 (1992).

The new rules expressly confirm the exclusion from CFTC regulation of specified transactions that "may be regarded as subject to the [CEA]," including privately-negotiated off-exchange "currency options" and "forward foreign exchange agreements" (to the extent they may be regarded as "futures") among professional traders and natural persons with total assets exceeding $10 million. 58 Fed. Reg. at 5588; 7 C.F.R. § 35.1. This demonstrates that Congress and the CFTC saw no basis for the concerns raised by Tauber but, on the contrary, wanted to confirm the lawfulness of off-exchange contracts. Since the regulation applies to all agreements entered after October 23, 1974, it also provides another ground for upholding the lawfulness of the parties' contracts in this case. (*Contrast* Pet. 4 n.2.)

[14] Tauber was able to negotiate futures and options contracts with other participants in the off-exchange market only because of his (1) experience in foreign currency trading; (2) access to "realtime" market information through his seat on the Philadelphia exchange and his personal access to "Telerate," a computerized quotation service; (3) maintenance of foreign bank accounts; and (4) large net worth, which allowed him to meet stringent collateral requirements and to enter into contracts of sufficiently large value to justify the expense of individualized negotiation. (Pet. App. 3a, 29a-30a). *See also* Hu, *Misunderstood Derivatives: The Causes of Informational Failure and the Promise of Regulatory Incrementlism* (Review Essay), 102 Yale L.J. 1547, 1465 & n.29 (1993) (noting that private individuals are generally unable to enter into OTC transactions in futures and options).

(Brief *Amicus Curiae* of the North American Securities Administrators Ass'n at 7.) The court of appeals warned that persons who attempt to engage in "mass marketing to small investors" will risk prosecution as unauthorized boards of trade. (Pet. App. 22a.)

This case, in sum, is not an appropriate vehicle for addressing the broad questions posed by Tauber. Those issues might be properly framed by a case questioning the CFTC's authority over the trading of foreign currency futures or options contracts with the general public. As the court of appeals observed with approval (Pet. App. 22a), another case recently confirmed the CFTC's regulatory authority in such circumstances, and we are aware of no decisions to the contrary. *CFTC* v. *Standard Forex, Inc.*, No. CV-93-0088 (E.D.N.Y., Aug. 9, 1993), *appeal dismissed.*[15] If a future court of appeals decision should actually raise the dangers hypothesized by Tauber, this Court will then have an appropriate factual context for determining whether the law needs clarification.

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[15] In *Standard Forex*, the CFTC sought to enjoin a firm operating an unregulated board of trade (a "bucket shop") and its officers from marketing standardized foreign currency futures contracts directly to the public. The CFTC alleged that the defendants sold foreign currency futures to Korean immigrants who in many cases did not speak English. *See Standard Forex*, slip op. at 12-15.

Granting the CFTC's application for a preliminary injunction and other relief, the district court rejected the defendants' claim that the Treasury Amendment excluded the transaction at issue from CFTC regulation under the CEA. *See id.* at 15-27. The court stressed, *inter alia*, that the district court's decision in the *Tauber* case "focused on an entirely different aspect of the [Treasury] Amendment" involving transactions that "occurred 'off-exchange.'" (Slip op. at 18.) The *Standard Forex* court also noted that the "unless" clause of the Treasury Amendment provides for regulation where marketing to the public creates a "formal structure" that is equivalent to a board of trade or exchange that is subject to CFTC regulation. *Id.* at 25.

B. There Is Unanimity in Government Views

Tauber also asserts that review by this Court is necessary because of a "wide divergence of views expressed by the federal government." (Pet. 17.) It is true that federal agencies have for many years taken differing positions on the full scope of the CFTC's regulatory powers. But *none* has concurred with Tauber's interpretation of the Treasury Amendment, and *all* have agreed that the contracts between Tauber and Salomon were lawful and enforceable on the facts of this case.

Thus the United States—on behalf of itself, the Department of the Treasury and the Securities and Exchange Commission—urged unqualified affirmance of the district court's judgment.[16] The Foreign Exchange Committee of the Federal Reserve Bank of New York agreed. (Foreign Exchange Comm. *Amicus* Br. at 14.)

The CFTC took a broader view of its regulatory authority than did the United States. But the Commission concluded that the district court's judgment (though not all of its reasoning) should be affirmed.[17] The CFTC

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[16] Taking issue with the same arguments petitioner asserts here, the United States stressed that "the Treasury Department's statutory interpretation has been in precise accord with the district court's interpretation of the reach of the Treasury Amendment . . . . 'All transactions in which foreign currency is the actual subject matter of an off-exchange contract for future delivery are exempt from the CEA.'" (United States *Amicus* Br. at 17 n.14.)

[17] The CFTC contended that the off-exchange futures contracts are valid as between traders (such as Salomon and Tauber) who are "within the class of banks, dealers and sophisticated and informed institutions" and that Tauber is a "'sophisticated foreign currency trader'" with long experience, vast assets, and his own foreign currency trading company. CFTC *Amicus* Br. at 17. The CFTC also argued that the "District Court Correctly Recognized On The Facts Of This Case That The Disputed [Option] Contracts Fall Within The Treasury Amendment" (*Id.* at 19).

also rejected Tauber's argument that the Treasury Amendment exclusion for "transactions in foreign currency" pertains only to actual transfers of currency itself. (CFTC *Amicus* Br. at 13.)

In his quest to find some conflict of views relevant to the facts of this case, Tauber cites—five times—a letter written by CFTC staff in a jurisdictional dispute with the SEC a year *after* the 1974 amendments to the CEA. (Pet. 9, 13, 18, 23, 25.) He mischaracterizes the letter as "the CFTC's contemporaneous interpretation of the 1974 Treasury Amendment." (Pet. 9.)[18] And his out-of-context quotations ignore the staff's express acknowledgment that the Treasury Amendment applies to off-exchange contracts.[19]

There is accordingly no basis for Tauber's assertion of a "wide divergence" of government agency views about the judgment at issue here. Since no government agency was even a party to this action, this case is a singularly inappropriate vehicle for resolving any supposed conflict in their positions.

C. There Is No Circuit Conflict Warranting Review

Tauber cites no case accepting his view that the Treasury Amendment applies only to transactions resulting in an actual delivery of foreign currency. Moreover, his

[18] Such contentions by staff personnel qualify as neither legislative history nor authoritative agency statements. *See, e.g., Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212 (1988); *Investment Co. Inst. v. Camp*, 401 U.S. 617, 627-28 (1971).

[19] The CFTC staff wrote:

> "The key word of the [Treasury Amendment] is 'unless' and 'unless' can have no other meaning than that the previously stated financial type instruments are subject to CFTC exclusive jurisdiction *when traded for future delivery on a board of trade*. When so traded, exclusive jurisdiction is crystal clear." SEC-CFTC Jurisdictional Correspondence, [1975-1977 Transfer Binder] Comm. Fut. L. Rep (CCH) ¶ 20,117, at 20,834 (CFTC Staff Response, emphasis added).

claim of a supposed conflict among the circuits rests (once again) on an unduly broad reading of the decision below (Pet. 14-17). There is no conflict among the circuits because no court (and no regulatory agency) has ever found privately-negotiated, off-exchange transactions among professional foreign currency traders to be regulated under the CEA. Tauber accordingly bases his argument on decisions confirming that *trading of standardized foreign currency contracts* (and other Treasury Amendment instruments) with the *general public* must take place on a CFTC-regulated board of trade or exchange—a proposition with which the court below *agreed*.

The lack of any genuine conflict is illustrated by Tauber's repeated quotation of the Seventh Circuit's observation that futures and options trading "occurs in 'the contract,' not in the commodity." (Pet. 13, 23, quoting *Chicago Mercantile Exch.* v. *SEC*, 883 F.2d 537, 542 (7th Cir. 1989), *cert. denied*, 496 U.S. 936 (1990).) That refers, of course, to the trading of standardized contracts conducted on or over an exchange,[20] and *not* to the off-exchange negotiation of contracts that "occurs in private transactions entered into directly by the counterparties . . . and are not secondarily traded." *1993 CFTC Report* at 74.

Tauber's reliance on the sharply split decision in *Board of Trade* v. *SEC*, 677 F.2d 1137 (7th Cir.), *vacated as moot*, 459 U.S. 1026 (1982), is four times removed from this case. *First*, there could be no circuit conflict because *Board of Trade* has been vacated and therefore has no precedential force.[21] *Second*, the case did not involve any

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[20] The exchange-traded contracts in *Chicago Mercantile Exchange* were "fungible because they have standard terms and each side's obligations are guaranteed by a clearing house." 883 F.2d at 542.

[21] The *Board of Trade* decision was vacated as moot when Congress specifically overruled the decision by amending the Securities Exchange Act to preserve the jurisdiction of the Securities and Exchange Commission ("SEC") over certain Government National

privately-negotiated, off-exchange transactions, but concerned competing jurisdictional claims by the CFTC and SEC over standardized Government National Mortgage Association ("GNMA") options that were being traded over exchanges. *Third*, the majority opinion turned not on the interpretation of the Treasury Amendment, but on another CEA provision granting the CFTC exclusive jurisdiction over transactions "involv[ing] contracts of sale . . . for future delivery." 677 F.2d at 1146. The court expressly declined to decide whether the Treasury Amendment affects the CFTC's jurisdiction over foreign currency options. *Id.* at 1155 n.34. *Fourth*, a later Seventh Circuit decision confirms (as did the court below) that the pertinent question under the Treasury Amendment is whether the contracts are privately negotiated off an exchange. *Abrams* v. *Oppenheimer Gov't Securities*, 737 F.2d 582, 590-92 (7th Cir. 1984).

Nor does *CFTC* v. *American Board of Trade, Inc.*, 803 F.2d 1242 (2d Cir. 1986) ("*ABT*"), conflict with the decision below. *ABT* rejected a Treasury Amendment defense presented by a self-styled (and unregulated) board of trade offering the general public standardized options contracts. As the court below correctly observed (Pet. App. 21a), *dicta* in *ABT* acknowledged the Treasury Amendment exclusion for off-exchange transactions between various financial institutions (an unduly narrow characterization), but held that the regulatory exclusion could in no event reach the marketing of unregulated options to the *general public*. 803 F.2d at 1249.[22]

Mortgage Association ("GNMA") and other securities options. *See* Memorandum for the Securities and Exchange Commission Suggesting Mootness 3, SEC v. Board of Trade, 459 U.S. 1026 (1982) (No. 82-526); *see also Golden Nugget, Inc.* v. *American Stock Exch., Inc.*, 828 F.2d 586, 589 (9th Cir. 1987) (discussing legislative history of 15 U.S.C. § 78i(g)).

[22] It should also be noted that *ABT* endorsed the CFTC's contention in that case (and below) that *exercised* foreign currency

II. THE DECISION BELOW IS CORRECT

The court of appeals stressed that the privately-negotiated foreign currency futures and options contracts between the two professional foreign currency traders here present the clearest case for application of the Treasury Amendment's exclusion from CEA coverage. (Pet. App. 22a.) This is undoubtedly correct. No matter what debate there may be about the CEA's application to the broader marketing and trading of futures and options contracts, the text and legislative history of the Treasury Amendment establish that Congress intended privately-negotiated foreign currency transactions among professionals in the off-exchange market to be excluded from regulation under the CEA.

1. As both the district court and the court of appeals found, the text of the Treasury Amendment is clear and unambiguous. It provides in relevant part:

> "Nothing in [the CEA] shall be deemed to govern or in any way be applicable to transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii).

Because the foreign currency contracts between Salomon and Tauber were *not* "conducted on a board of trade" (Pet. App. 35a), those transactions are excluded from CEA coverage by the plain language of the Treasury Amendment.

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options, such as those at issue here (Pet. App. 41a), are completed transactions in foreign currency that are excluded from CEA regulation under any view of the Treasury Amendment. The *ABT* court observed, without regard to whether there is ever an actual delivery of currency, that a foreign currency option contract "does not become a 'transaction in' that currency unless and until the option is exercised." 803 F.2d at 1248. Both the CFTC and the United States urged this principle before the court of appeals as an alternative ground for affirming the district court's judgment in this case because the options were exercised. *See* CFTC *Amicus* Br. at 19-20; United States *Amicus* Br. at 23-24.

2. The legislative history of the Treasury Amendment confirms that the decision below is correct. As the Treasury Department wrote when it proposed the amendment:

> "The Department feels strongly that foreign currency futures trading, other than on organized exchanges, should not be regulated by the new agency. . . . The participants in th[e] [dealer] market are sophisticated and informed institutions, unlike the participants on organized exchanges, which, in some cases, include individuals and small traders who may need to be protected by some form of governmental regulation . . . . [N]ew regulatory limitations and restrictions could have an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors." (pp. 1a-2a, *infra.*)

The Senate Committee on Agriculture and Forestry focused precisely on a regulatory exclusion for "foreign currency and certain enumerated financial instruments unless such trading is conducted on a formally organized futures exchange." [23] And petitioner is simply wrong in asserting that congressional committees avoided "any reference to futures" in their comments on the Treasury Department's proposed amendment.[24] Because Tauber's

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[23] S. Rep. No. 1131, 93d Cong., 2d Sess. (1974), *reprinted in* 1974 U.S.C.C.A.N. 5843, 5863. The Senate Report mentions foreign currency *futures*, and does not refer to *options*, because foreign currency options trading arose after the Treasury Amendment was enacted in 1974. *See, e.g., Evolving Regulatory Framework* at 56 (explaining that off-exchange foreign currency options should be covered by the Treasury Amendment); Chrystal, *A Guide to Foreign Exchange Markets*, Fed. Reserve Bank of St. Louis Rev. 10 (March 1984) (options were a "new feature of foreign exchange markets that [arose] in the 1980's.") The Board of Governors of the Federal Reserve regards the Treasury Amendment as covering off-exchange "futures, and currency options transactions as well." Letter from Board of Governors to CFTC at 2 (March 5, 1986).

[24] *See* S. Rep. No. 93-1131, 93d Cong., 2d Sess., *reprinted in* 1974 U.S.C.C.A.N. at 5887: "in a letter to the [Senate] Committee [on Agriculture and Forestry] . . . the Department of the Treasury recommended that a provision be included in the legislation ex-

transactions with Salomon were privately negotiated and did not occur on any exchange, the court below correctly held that these transactions were covered by the Treasury Amendment and thus were not prohibited by the CEA.

3. Tauber's "textual" interpretation of the Treasury Amendment was rejected as implausible and mischievous by all federal government *amici*, each of which is familiar with the foreign currency markets.[25] The construction offered in the petition never occurred to Tauber during his many years of off-exchange trading of foreign currency futures and options with Salomon and others, and did not dawn on him until his appeal to the Fourth Circuit.[26] The court of appeals arrayed many clear and compelling reasons for rejecting Tauber's textual arguments (Pet. App. 15a-19a), and there is no reason to repeat them here.[27]

4. Congress did not distinguish among different types of foreign currency transactions when it adopted the Treasury Amendment. Its broad language excludes *all* privately-negotiated off-exchange transactions from CEA regulation. Tauber's attempt to read the Amendment as covering only those transactions that actually result in the delivery of foreign currency is unprecedented and incompatible with the way the foreign currency markets have long operated under the law.

Thus, at the broadest level, Tauber's interpretation ignores the vast off-exchange market, consisting of privately-negotiated futures and options transactions rarely resulting

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empting, from regulation by the Commission, foreign currency futures trading other than on organized exchanges."

[25] United States *Amicus* at 19-20; CFTC *Amicus* Br. at 13; Foreign Exchange Comm. *Amicus* Br. at 15-25.

[26] *See* note 10, *supra*.

[27] Tauber now argues that 7 U.S.C. § 6c(f) somehow shows that options trading must "take place on a regulated exchange." (Pet. 24.) To the contrary, the provision confirms that the SEC (not the CFTC) has jurisdiction over *on-exchange* trading of such options on a *securities* exchange.

in delivery, that has never been regulated by the CFTC. Nor does Tauber's "actual delivery" gloss satisfactorily explain why the broadly-worded Treasury Amendment was necessary to confirm what has always been a central principle of the CEA—that contacts for actual or deferred delivery of a commodity are not subject to regulation as futures or options.[28] And carrying the point further, Tauber's interpretation cannot account for—and would sweep under CFTC regulation—the enormous volume of off-exchange "spot" transactions that do not (and are not intended to) result in any delivery of foreign currency. *See Bank Brussels Lambert, S.A.* v. *Intermetals Corp.*, 779 F. Supp. 741, 748-50 (S.D.N.Y. 1991).

Thus, by focusing on actual delivery of currency as triggering the Treasury Amendment, petitioner would not only make it redundant of the existing statutory exclusions, but actually would *expand* regulation over important classes of transactions that would be excluded even if the Treasury Amendment had never been enacted. That is only one perverse consequence of Tauber's "textual" interpretation of a statutory amendment that was enacted not to *broaden* regulation under the CEA, but to declare sweepingly that "[n]othing in [a statute regulating trading of futures and options contracts] shall be deemed to govern or in any way be applicable to transactions in foreign currency" that would otherwise be regulated.

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[28] There is not a shred of legislative history hinting that the "real" purpose of the Treasury Amendment was to prevent the CFTC from regulating *cash* foreign currency transactions. (*See* Pet. 25.) The Treasury Department's letter is to the contrary, and there would have been many simpler and narrower ways to address the point if that had been the objective.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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March 17, 1994

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APPENDICES

APPENDIX A

The General Counsel Of The Treasury,
Washington, D.C., July 30, 1974.

Hon. Herman E. Talmadge,
Chairman, Committee on Agriculture and Forestry,
U.S. Senate, Washington, D.C.

Dear Mr. Chairman: The attention of the Department has been directed to H.R. 13113, S. 2485, S. 2578 and S. 2837, bills to regulate future trading in agricultural and other commodities, which are currently pending before your Committee.

Each of these bills would estabilsh a Federal regulatory agency with sweeping authority to regulate futures trading in virtually any commodity, good, article, right or interest. This authority would extend to the regulation of futures trading in foreign currencies. Moreover, H.R. 13113 and S. 2578 would amend the Commodity Exchange Act, 7 U.S.C. Sec. 1, *et seq.*, to subject futures trading in foreign currencies to the regulatory requirements of that Act.

The Department believes the bills contain an ambiguity that should be clarified. The provisions of the bills do not clearly indicate that the new regulatory agency's authority would be limited to the regulation of futures trading on organized exchanges, and would not extend to futures trading in foreign currencies off organized exchanges. We do not believe that either the House of Representatives or your Committee intends the proposed legislation to subject the foreign currency futures trading of banks or other institutions, other than on an organized exchange, to the new regulatory regime.

The Department feels strongly that foreign currency futures trading, other than on organized exchanges, should not be regulated by the new agency. Virtually all futures

trading in foreign currencies in the United States is carried out through an informal network of banks and dealers. This dealer market, which consists primarily of the large banks, has proved highly efficient in serving the needs of international business in hedging the risks that stem from foreign exchange rate movements. The participants in this market are sophisticated and informed institutions, unlike the participants on *organized* exchanges, which, in some cases, include individuals and small traders who may need to be protected by some form of governmental regulation.

Where the need for regulation of transactions on other than organized exchanges does exist, this should be done through strengthening existing regulatory responsibilities now lodged in the Comptroller of the Currency and the Federal Reserve. These agencies are currently taking action to achieve closer supervision of the trading risks involved in these activities. The Commodity Futures Trading Commission would clearly not have the expertise to regulate a complex banking function and would confuse an already highly regulated business sector. Moreover, in this context, new regulatory limitations and restrictions could have an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors.

Section 201 of H.R. 13113 currently contains broad language that would appear to authorize the new agency to regulate bank foreign currency departments. Section 201 provides that the new Commodity Futures Trading Commission would have "exclusive jurisdiction of transactions dealing in, resulting in, or relating to contracts of sale of a commodity for future delivery, traded or executed on a domestic board of trade, contract market or on any other board of trade, exchange, or market." The bill would amend the Commodity Exchange Act, 7 U.S.C. 1 *et seq.*, to broaden the definition of commodity to include all goods, articles, services, rights and interests

"in which contracts for future delivery are presently or in the future dealt in." (Section 201). Since this definition would encompass foreign currencies, it seems clear that the language of the bill would give the Commission authority to regulate futures trading in foreign currencies by banks. Moreover, the language "or any other board of trade, exchange, or market" is sufficiently broad to authorize the Commission to regulate trading in foreign currencies by banks in the over-the-counter market.

S. 2837, S. 2485 and S. 2578 are also, in our view, unclear whether they would authorize the regulation of futures trading in foreign currencies by banks. For example, section 301 of S. 2837 provides that it "is unlawful for any person to buy or sell, or offer to buy or sell, any futures contract except on an exchange registered under section 201." Section 201(a) provides that it is unlawful for an exchange to permit futures contracts to be traded on it unless the exchange is registered with the Futures Exchange Commission. A futures contract is defined as "an agreement to buy or sell for delivery at a future time any specified quantities of goods, services, or other tangible or intangible things." (Section 102(3)). This definition is broad enough to include futures contracts in foreign currencies. The term "exchange" is defined broadly to mean "any place where futures contracts are traded." (Section 102(10)).

Accordingly, S. 2837 could be construed to prohibit banks from engaging in futures trading in foreign currencies unless they registered as an exchange with the new Futures Exchange Commission and became subject to its regulation. We believe that this is a serious defect in the proposed legislation that would, if enacted, impair the usefulness and efficiency of our foreign exchange markets.

In addition, the Department is concerned that the language of the bill is broad enough to subject to regulation by the proposed futures trading regulatory agency a wide

variety of transactions involving financial instruments, such as puts and calls, warrants, rights, resale of installment loan contracts, repurchase options in Government securities, Federal National Mortgage Association mortgage purchase commitments, futures trading in mortgages contemplated by Federal Home Loan Mortgage Corporation, etc. We feel that regulation of these transactions, which generally are between large, sophisticated institutional participants, is unnecessary, and could be harmful. For this reason, we do not believe it is contemplated that the bills should regulate transactions in financial instruments of that nature.

In view of the foregoing, we strongly urge the Committee to amend the proposed legislation to make clear that its provisions would not be applicable to futures trading in foreign currencies or other financial transactions of the nature described above other than on organized exchanges. This could be accomplished by inserting a new section at an appropriate place reading as follows:

"Sec. —. Nothing in this Act shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, re-purchase options, government securities, mortgages and mortgage purchase commitments, or in puts and calls for securities, unless such transactions involve the sale thereof for future delivery conducted on a board of trade."

The Department has been advised by the Office of Management and Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

Donald L. E. Ritger.
Acting General Counsel.

APPENDIX B

SALOMON INC SUBSIDIARIES

Phibro Energy AG
- Phibro Energy Futures Limited
- Phibro Energy (Asia) Pte. Ltd.
- Phibro Energy Trading AG
- Scanports Shipping Ltd.

Phibro Energy Clearing, Inc.
Phibro Energy Commodities Limited
- Phibro Energy Marketing Limited

Phibro Energy International Ltd.
Phibro Energy International Sales Corp.
Phibro Energy Oil, Inc.
Phibro Energy Production, Inc.
- Phibro Energy International Oil Company, Inc.
- White Nights Joint Enterpirse (38.75% owned)

Phibro Energy Trading Pte. Ltd.
Phibro Energy USA, Inc.
- Phibro Gas Properties, Inc.
- Moss Bluff Gas Storage Systems (50% owned)
- Phibro Gas Resources, Inc.
- Questor Drilling Corp.

Philipp Brothers, Inc.
Philipp Brothers Ltd.
Scanports Shipping, Inc.
Salomon Brothers Holding Company Inc
- Loan Participation Holding Corporation
  - Home Mortgage Access Corporation
    - Home Mac Government Financial Corporation
    - Home Mac Government Financial Corporation West
    - Home Mac Mortgage Securities Corporation
- PB-SB Investments Inc.
- PB-SB Ventures Inc.
- Salomon International Finance AG
- Salomon Brothers Asia Ltd.
- Salomon Brothers Overseas Inc.

Salomon Brothers Europe Ltd.
- Salomon Brothers International Limited
- Salomon Brothers U.K. Limited
- Salomon Brothers U.K. Equity Limited
- The Mortgage Corporation Group Limited
  - The Mortgage Corporation Limited

Plaza Clearing Corporation
Salomon Brothers Asset Management Inc.
Salomon Brothers Australia Limited
Salomon Brothers Canada Holding Co.
Salomon Brothers Finanz AG
Salomon Brothers Hong Kong Limited
Salomon Brothers Inc
- Salomon Brothers International, Inc.

Salomon Brothers Mortgage Securities, Inc.
Salomon Brothers Mortgage Securities II, Inc.
Salomon Brothers Mortgage Securities III, Inc.
Salomon Brothers Mortgage Securities V, Inc.
Salomon Brothers Mortgage Securities VI, Inc.
Salomon Brothers Mortgage Securities VII, Inc.
Salomon Brothers Pacific Holding Company Inc.
Salomon Brothers Properties, Inc.
- Broadwater Corp.
- Salomon Brothers Investments Inc.
- SB Financing Corp.

Salomon Brothers Realty Corp.
Salomon Brothers Real Estate Development Corp.
Salomon Brothers Receivables Inc.
Salomon Brothers S.A.
Salomon Capital Access for Savings Institutions, Inc.
- Salomon Capital Access Corporation

Salomon Forex Inc
- Salomon Brothers Finance Corporation

Salomon Plaza Holdings Inc.
- Plaza Holdings, Inc.
  - Salomon Brothers Financial Corporation & Co. beschrankt haftende KG
  - Salomon Brothers AG

Salomon Brothers Kapitalanlagegsellschaft mbH
Salomon Brothers Services GMBH
Salomon Swapco Inc.
SB/DP Participation Corp.
SB/EJV Participation Corp.
SB/OT Participation Corp.
SBSIM, spa
The S.W. Shattuck Chemical Co., Inc.

Supreme Court, U.S.
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No. 93-1314

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

No. 93-1314

LASZLO N. TAUBER, M.D.,
Petitioner,

v.

SALOMON FOREX, INC., SALOMON INC.,
SALOMON BROTHERS, INC., and FRED GATLING
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF *AMICUS CURIAE* OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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AUTHORITY TO FILE AND POSITION OF AMICUS CURIAE

This brief is filed pursuant to the Court's Rule 37.2 by written permission of the parties to the case, and their written permission is filed herewith. This brief supports the position of the Petitioner.

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BRIEF *AMICUS CURIAE* OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

STATEMENT OF THE INTEREST OF THE *AMICUS CURIAE*

This brief, filed on behalf of the North American Securities Administrators Association, Inc. ("NASAA"), addresses the question whether commodity futures contracts and commodity options on foreign currency transactions are excluded from the jurisdiction of the Commodity Exchange

Act, 7 U.S.C. § 2 ("CEA").

NASAA is the association of the 65 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum where securities regulators work together to protect investors at the grassroots level and to promote fair and open capital markets. NASAA speaks as the collective voice for its members in forwarding those interests.

NASAA's interest in this case arises from the potential impact that the decisions of the District Court and Court of Appeals[1] may have on federal and state investor protection statutes regulating sales of securities, commodity futures, and other intangible investments. Commodity futures markets, like securities markets, are essential elements of the American financial system. American commodities and securities markets are universally acknowledged to be the most stringently regulated capital markets in the world, and state securities regulators believe it is no coincidence that these are also the world's strongest capital markets. The Fourth Circuit decision creates a potential regulatory gap in an area of investment laws which has been subject to repeated past abuses -- off-exchange futures and option contracts. If the decision is allowed to stand it could damage the integrity of U.S. capital markets, cause losses to the investing public, and strain state and federal resources required to enforce investment related statutes.

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[1] The opinion of the District Court is reprinted in the Appendix to the Petition for Writ of Certiorari, Pet. App. 27a-44a, and reported at 795 F. Supp. 768. The Court of Appeals opinion is reprinted at Pet. App. 1a-26a and reported at 8 F. 3d 966.

Beginning with the naked commodity option boiler room operations of the early 1970's which, at least in part, prompted Congress to create the Commodity Futures Trading Commission ("CFTC") in 1974,[2] state and federal law enforcement authorities have had to deal with a series of off-exchange, unregistered commodity options and other contracts being sold by boiler room "telemarketers" to unsophisticated members of the general public in attempts to avoid scrutiny by any investor protection agency. Because their schemes cannot stand regulatory scrutiny, these promoters have often claimed that their investment vehicles "fall through the cracks" between regulated securities and commodities related products and that they are "like" a legitimate but unregulated investment, such as the cash forward commodity market. Often the very commodity at issue here, foreign currency, has been the investment purveyed by these new bucket shops.

The states, CFTC, and self-regulatory organizations have worked together to assure that the leakage of illicit schemes through regulatory cracks is as small as possible, and Congress has amended the CEA as needed to fill those gaps.[3] NASAA has an interest in this case because the Fourth

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[2] Commodity Futures Trading Commission Act of 1974, 88 Stat. 1389 (hereinafter, the "CFTC Act"). The necessity for regulation of options transactions also led to amendments in 1978. SEN. REP. NO. 850. 95th Cong., 2d Sess. 10, *reprinted in* 1978 U.S.C.C.A.N. 2087, 2102-2103.

[3] House Agriculture Committee Chairman Pogue, the sponsor of the CFTC Act, explained in 1974 that the CFTC was created "to fill all regulatory gaps -- to regulate trading in futures and in options relating to commodities or commodity futures, because such trading is now poorly regulated if it is regulated at all." 120 Cong. Rec. 34736 (1974).

Circuit opinion creates a new vacuum which confidence men would eagerly fill. The Fourth Circuit failed to apply the *law* to the *facts*, and its sweeping interpretation of the "Treasury Amendment,"[4] in effect excludes all futures and options transactions in foreign exchange from CFTC oversight. This case should be reversed and returned to the district court for a factual determination of the nature of the products sold under a rational reading of the CEA.

REASONS FOR GRANTING THE WRIT

The definition of "security" under the federal securities laws is critical. It determines the scope and jurisdiction of the federal securities acts. The Supreme Court has interpreted the definition of "security" on many occasions since adoption of the Securities Act of 1933.[5] The definition and jurisdiction provisions of the Commodity Exchange Act have not received nearly so much attention, despite statutory origins reaching back to 1921.[6] The Court should grant review of this case because of the importance of the issue to be decided -- the scope of the CEA -- for the U.S. financial regulatory system, the safety of our capital markets, and investor confidence. In addition, the case presents a conflict between the Fourth Circuit, on one hand, and the Second and Seventh Circuits, on the other, in the interpretation of the

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[4] 7 U.S.C. § 2(ii).

[5] 15 U.S.C. § 77a, *et seq.*

[6] For a review of the history of the CEA and its predecessor, the Futures Trading Act, *see,* William L. Stein, *The Exchange-Trading Requirement of the Commodity Exchange Act,* 41 Vanderbilt L. Rev. 473, 477 (1988).

jurisdiction of the CEA and the CFTC.

Finally, the case merits the attention of the Court to correct a serious error made by the lower courts which could have widespread, adverse consequences for investor protection laws. Congress, in adopting the CEA, recognized the legitimacy of existing commercial transactions, such as "cash" and "cash forward" contracts for many physical commodities and foreign currency transactions between institutional and commercial users. It created narrow exceptions to the CEA, including the Treasury Amendment, to allow those markets to continue their operation without additional interference from the government. Congress did not, however, adopt a *carte blanche* exclusion from regulation for foreign currency or any other commodity when traded under circumstances that would foster new bucket shop abuses.

The issue in this case, whether the transactions between Petitioner and Respondents fell within the coverage of the CEA, was decided on motion for summary judgment. The Courts below assumed that the disputed transactions involved futures contracts or commodity option contracts which would have been covered by the CEA but for the exclusionary language of the Treasury Amendment. In so doing, the Courts below failed to make a crucial, factual analysis and reopened loopholes in the regulatory structure that the Congress, states, CFTC, and self-regulatory organizations have spent years plugging.

This case presents an important opportunity for the Supreme Court to announce for the first time its interpretation of the modern CEA and the jurisdictional reach of that statute.

A. THE DECISION BELOW PRESENTS AN IMPORTANT QUESTION CONCERNING THE SCOPE OF THE COMMODITY EXCHANGE ACT.

The Commodity Exchange Act regulates financial transactions, depending on the nature of the transactions and marketplace in which they occur, and dictates that certain kinds of transactions must occur in certain regulated markets. The CEA confines trading in contracts for future delivery to boards of trade that are designated contract markets for those contracts, and it strictly proscribes trading in other, off-exchange instruments such as commodity options except under circumstances permitted under the Act and CFTC regulations. 7 U.S.C. § 6, 6c. This is a salient feature of the provisions in the CEA that prohibit the creation of bucket shops and the centerpiece of the CEA regulatory scheme.

The CEA provides that the jurisdiction of the CFTC to regulate commodity futures, option, and leverage contracts is exclusive, and that state regulatory authority is preempted as to covered transactions. 7 U.S.C. § 2(i). This regulatory regime differs from securities regulation, where jurisdiction of the state and federal governments is shared and largely co-extensive.[7] For transactions in which state jurisdiction is preempted, however, the comprehensive provisions of the CEA apply and the CFTC has regulatory and enforcement

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[7] State jurisdictional savings provisions are contained in the Securities Act of 1933, 15 U.S.C. § 77r, the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a), the Investment Company Act of 1940, 15 U.S.C. § 80a-49, the Investment Adviser's Act of 1940, 15 U.S.C. § 80b-18a, and the Trust Indenture Act, 15 U.S.C. § 77zzz.

powers. States do retain authority over transactions not conducted on a contract market, not regulated by a foreign exchange, and not subject to the CFTC's exclusive jurisdiction of regulated commodity options or leverage transactions, as well as over persons required to be licensed under the CEA who are not so licensed.[8]

Prior to the adoption of the amendments to the CEA, state securities regulators and the SEC litigated a number of cases for enforcement of securities laws against bucket shop operators who were selling "naked" commodity options on the "world commodities" that, prior to 1974, were not regulated by the CFTC.[9] These options often represented nothing more than a bet between the investor and dealer on the price of the commodity being sold.[10] Past abuses in commodity option transactions have indeed been so great that, before adoption of the CFTC Act, commodity options on the agricultural goods that the CEA covered was banned altogether, and after an unsuccessful experiment, options trading was again banned from 1978 to 1983 until the CFTC completed a comprehensive overhaul of options trading

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[8] 7 U.S.C. § 13a-2. *See,* II P. Johnson & T. Hazen, *Commodities Regulation* § 3.98 (2d ed. 1989 & Supp. 1992).

[9] *See,* Joseph C. Long, *The Naked Commodity Option Contract as a Security,* 15 WILLIAM AND MARY L. REV. 211, 213-218 (1973) (hereinafter "Long"); *Board of Trade v. SEC,* 677 F. 2d 1137, 1142-1143 (1982), *vacated as moot* 459 U.S. 1026 (1982).

[10] Long, at 211-12.

regulation.[11] After adoption of the CFTC Act brought the world commodities and commodity options under the CEA, illicit promoters have continued to sell the same or similar investments under claims that they represented, not commodity options which are subject to CFTC jurisdiction, but other contracts denominated as "cash forward" contracts, as well as foreign currency contracts. The purpose is simply to evade regulatory scrutiny.[12]

A leading case on enforcement of the CEA against such schemes is *CFTC v. Co Petro Marketing Group, Inc.*, 680 F. 2d 573 (9th Cir. 1982). That case involved sales to the general public of investments in contracts for the purchase of gasoline.[13] The Court had no difficulty finding that the

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[11] The CFTC Act continued the ban on agricultural options and brought options on other commodities under the CEA. SEN. REP. NO. 1131, 93d Cong., 2d Sess. 4 (1974). In 1978 commodity options were first banned by CFTC rule, 43 F.R. 16153 (April 17, 1978), and then by statute, Pub. L. No. 95-405, 92 Stat. 865, 867. The 1978 ban was repealed the Futures Trading Act of 1982, Pub. L. 97-444, 96 Stat.2294, which made all options trading subject to strict regulation by the CFTC.

[12] Off-exchange commodity futures and options that have been promoted as "unregulated" commodity transactions include precious metals "forwards", *CFTC v. American Metals Exchange*, 693 F. Supp. 168 (D. N. J. 1988); coal contracts, *CFTC v. National Coal Exch., Inc.*, Comm. Fut. L. Rep. (CCH) ¶ 21,424 (W. D. Tenn. 1982); and foreign currency options, *CFTC v. American Board of Trade*, 803 F. 2d 1242, (2d Cir. 1986) (discussed *infra*, in Part B), and *CFTC and State of Georgia v. Sterling Capital Company*, Comm. Fut. L. Rep. (CCH) ¶ 21,169 (N.D. Ga.), *modified in other respects*, Comm. Fut. L. Rep. (CCH) ¶21,170 (N.D. Ga. 1981).

[13] One of the *Co Petro* defendants, Harold Goldstein, had a history of legal proceedings against him resulting from his sales in the 1970's of naked commodity options described in Professor Long's article. *Co*

contracts were illegal, off-exchange contracts for future delivery, where the contracts were sold for speculative purposes, were not predicated upon the expectation that delivery of gasoline would occur, were of relatively standardized form, and were at prices set unilaterally by the promoter based on spot market rates. *Id.*, at 580-581.

Securities regulators have traditionally attacked boiler rooms such as the commodity option bucket shops as illegal investment contracts, using the classic definition laid down by the Supreme Court in *SEC v. W. J. Howey Co.*[14] The CFTC Act created a new agency with new enforcement tools specifically to combat commodity fraud, including limited authority of states to bring enforcement actions under the CEA under 7 U.S.C. § 13a-2. Eighteen states have adopted versions of the Model State Commodity Code,[15] promulgated by NASAA, to exercise state enforcement authority to the fullest extent allowable under the CEA.[16]

As will be shown in Part C of this brief, the Fourth Circuit has made a significant and unwarranted expansion of a narrow exclusion to the CEA regarding foreign currency transactions. History has amply demonstrated the willingness

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Petro, at 584; *Long*, at 214-215.

[14] 328 U.S. 293 (1946). The *Howey* test requires proof that the disputed instrument is (1) an investment of money (2) for profit (3) in a common enterprise (4) with the expectation that the profit will come from the efforts of others.

[15] NASAA Rep. (CCH) ¶ 4401, *et seq.*.

[16] A list of states and statutory references for the Model State Commodity Code is located in NASAA Rep. (CCH) ¶ 264.

of fraudulent promoters to exploit such a weakness. A review of that decision and definitive pronouncement by the Supreme Court is therefore necessary.

B. THE COURT SHOULD GRANT CERTIORARI BECAUSE THERE IS A CONFLICT AMONG THE CIRCUITS ON THE SCOPE OF THE TREASURY AMENDMENT.

The Second and Seventh Circuits have reached decisions on the Treasury Amendment that differ from the Fourth Circuit's in this case. The opinion below discussed both of these cases but concluded incorrectly that its own decision was consistent with them.

In *CFTC v. American Board of Trade,* 803 F. 2d 1242 (2d Cir. 1986), the Court affirmed an injunction prohibiting a company from selling commodity options on, among other things, foreign currency. The Defendant contended that the Treasury Amendment excluded its currency options from CEA jurisdiction. The Court held:

> An option transaction giving the option holder the right to purchase a foreign currency by a specified date and at a specified price does not become a "transaction in" that currency unless and until that option is exercised. . . . Hence the Treasury Amendment did not, on its face, appear to exclude defendants' foreign currency options business from regulation. *Id.,* at 1248.

The Second Circuit opinion reviewed the legislative history of the Treasury Amendment, including the letter from the Treasury Department which has been the subject of much

debate in the briefs and opinions in the present case, and drew a different conclusion than did the Fourth Circuit. In *CFTC v. American Board of Trade*, the Court found that the Treasury Amendment was included in the CEA because "the protections of the Act were not needed for the sophisticated financial institutions already subject to regulation, that participated in such transactions", and that it was not designed to "exclude from regulation foreign currency options transaction such as those defendants engaged in with private individuals." *Id.*, at 1249.

CFTC v. American Board of Trade cannot be harmonized with the Fourth Circuit's opinion. The Second Circuit held that the Treasury Amendment was directed at a specific market, comprised of financial institutions and sophisticated dealers. The Fourth Circuit held flatly that all futures trading in foreign currencies is excluded from CEA jurisdiction.

> We are thus satisfied that under the appropriate interpretation of the Treasury Amendment, all off-exchange transactions in foreign currency, including futures and options, are exempted from regulation by the CEA. Pet. App. 17a.

Though the Fourth Circuit recognized that a key factor in *CFTC v. American Board of Trade* was the nature of the parties involved, Pet. App. 21a, the Fourth Circuit opinion disagrees with the Second Circuit on both the purpose of the Treasury Amendment and its scope, because the Fourth Circuit reached its decision without making the necessary inquiry into the facts surrounding the market and the participants in the disputed trades.

Likewise, the Fourth Circuit does not square with the Seventh Circuit decision in *Board of Trade v. SEC, supra,* note 3. That case involved a jurisdictional dispute over the authority of the SEC to approve options on government securities for trading on a national securities exchange. The Seventh Circuit found that the SEC lacked that authority because the instruments involved were commodity options subject to regulation under the CEA. The SEC argued that the Treasury Amendment exclusion of transactions in government securities applied to options on them, which were being traded on the Chicago Board Options Exchange. The Court held that an option on a government security is not a transaction in the government security itself, because "the options market may exist without any transactions in the commodity itself." *Id.*, at 1154.

Board of Trade v. SEC also held that the legislative history of the Treasury Amendment made it "quite clear" that the amendment was adopted only to prevent dual regulation by the bank regulators and CFTC of the interbank market for these instruments. *Id.*

The Fourth Circuit stated that *Board of Trade v. SEC* was based upon the fact that the instruments involved were traded on an "exchange." Pet. App. 22a. Such is not the case. In *Board of Trade v. SEC*, once the Seventh Circuit found that options covered by the CEA were being traded, the result was that such instruments could only be traded under the auspices of the CFTC. *Board of Trade v. SEC,* at 1143-1144. The Seventh Circuit correctly based CEA jurisdiction on the existence of a regulated transaction (commodity options) rather than a regulated "exchange," *i.e.*, board of

trade or contract market.[17] The Fourth Circuit wrongly concluded, in conflict with the Second and Seventh Circuits, that options could only be regulated if traded on an "exchange," a term not defined in the CEA nor used in the Treasury Amendment.

The Fourth Circuit's dicta, at Pet. App. 25a-26a, on the nature of the markets or sophistication of the Petitioner lends no support to its own direct holding that all off-exchange futures and trading in foreign currencies is exempt from CEA jurisdiction. The opinions below did not make necessary findings regarding the marketplace and market participants, as were undertaken in *CFTC v. American Board of Trade* and *Board of Trade v. SEC;* they are odds with the holdings of those circuits and should be reviewed by the Supreme Court.

C. THE COURT SHOULD GRANT CERTIORARI BECAUSE THE FOURTH CIRCUIT MISINTERPRETED THE SCOPE OF THE CEA AND THE TREASURY AMENDMENT.

Prior to 1974, the CEA covered only a narrow list of "agricultural commodities" in which futures trading occurred on established and recognized U.S. contract markets.[18] The CFTC Act expanded the definition of commodities to encompass other marketplace activities in items then known

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[17] Under the CEA, commodity options, unlike contracts for future delivery, may be traded "off-exchange" under CFTC regulations. In *Board of Trade v. SEC,* whether the trading took place on an "exchange" was not a factor in the decision at all. *See, Board of Trade v. SEC,* at 1143, note 12, and 1144, note 13.

[18] Long, at 213-214.

as "world commodities" as well as in "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. § 1a(3). In determining the coverage of the CEA, the emphasis is placed on whether an activity is the subject of *futures trading* under the Act, or another activity covered by the Act such as commodity options trading. If an activity is regarded as futures trading, it must take place on a "contract market" designated by the CFTC.

> (a) It shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a *contract for the purchase or sale of a commodity for future delivery* (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) unless --
>
> (1) such transaction is conducted on or subject to the rules of a *board of trade* which has been *designated by the Commission as a "contract market"* for such commodity; 7 U.S.C. § 6.[19] (Emphasis added.)

The leading commentators in the field have described this

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[19] Subsections (2) and (3) of Section 6, not relevant here, require that the futures contract be executed by a member of the contract market and that the futures contract be evidenced by a writing.

provision as the "monopoly" of the contract markets.[20] To understand the statutory framework that this approach creates, it is necessary to understand the relationship of the terms used in Section 6 to each other. This the Fourth Circuit failed to do.

The lower courts and the CFTC have laid down what have become known as the "indicia" of futures contracts:[21]

> . . . they involve the purchase or sale of a commodity for delivery in the future at a price or pricing formula that is agreed upon when the transactions are initiated; they are standardized as to terms and conditions other than price; unlike commercial forward contracts or traditional installment agreements, they are undertaken primarily to assume or shift the risk of commodity price changes and generally entered into for purposes of obtaining delivery of the commodity, but rather are discharged through offsetting transactions or other buy-back arrangements. 50 F.R. 11656; Comm. Fut. L. Rep. (CCH) ¶ 22,518 (CFTC Office of General Counsel Interpretation, March

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[20] I Johnson & Hazen, § 1.06.

[21] The term "future delivery" is defined in the CEA only by a negative statement. Whatever future delivery is, it is defined to exclude "any sale of any cash commodity for deferred shipment or delivery." 7 U.S.C. § 1a(11). The exclusion is generally interpreted to cover cash or "spot" transactions and "commercial, merchandising transactions in physical commodities in which delivery actually occurs but is delayed or deferred for commercial purposes." *Regulation of Hybrid and Related Instruments*, 2 Comm. Fut. L. Rep. (CCH) ¶ 23,995, at 34,942 (CFTC , Dec. 11, 1987).

25, 1985).[22]

If contracts for future delivery are involved, the CEA requires that the contracts must be traded on a board of trade that has been designated as a contract market by the CFTC. 7 U.S.C. § 6. As noted in *Co Petro, supra*, at 581, "board of trade" is defined broadly in the CEA to "include or mean any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling commodity or receiving the same for sale on consignment." *Co Petro* held that a single company in business to purvey its contracts for future delivery could be an association covered by the "board of trade" definition, where its contracts otherwise included the elements of futures trading and were marketed to the general public.

The Fourth Circuit held that CFTC authority to prevent fraud and abuse in foreign currency transactions only extended to those transactions that take place on the floor of a commodities exchange. The Fourth Circuit failed to understand that the reference, in 7 U.S.C. § 2(i), to trading futures contracts on a "contract market" or a "board of trade" in the jurisdictional provision, though unartfully expressed,

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[22] The Office of General Counsel also noted that characteristics common to futures contracts would include standardized terms, initial deposit and maintenance of "margin" or like payments, and right or interest in the customer in a particular lot or other commodity unit. 50 F.R. 11656, 11657 at note 2. *See also, In re Stovall,* Comm. Fut. L. Rep. (CCH) ¶ 20,941 (1979), listing as four "classic" elements, standardized contract terms, instruments directly or indirectly offered to the general public, earnest money or margin for security, and transactions primarily for the purpose of shifting risk rather than for transferring ownership of commodities.

is only a recitation of the requirement that trading take place on a contract market, and not part of the definition itself. To hold otherwise guts the bucket shop prohibition in the CEA by allowing futures trading to occur elsewhere than on designated contract markets. The Fourth Circuit interpretation, that foreign currency trading may only be regulated by the CFTC *if* the trading is on a con act market, is a case of circular logic -- the Court looks to the market and sees if the CFTC regulates that market, to tell whether the CFTC regulates it.

As the CFTC and the Ninth Circuit have said, "the requirement that a futures contract be executed on a designated contract market is what makes the contract legal, not what makes it a futures contract." *In re Bybee,* 945 F. 2d 310, 313 (9th Cir. 1991); citing *First National Monetary Corp.,* Comm. Fut. L. Rep. (CCH) ¶ 22,698, at 30,970 (1985).

This *amicus curiae* brief adopts the view of the legislative history of the Treasury Amendment put forth in Mr. Tauber's Petition for Writ of Certiorari. Pet. for Cert. 26-29. That history indicates that the Treasury Amendment is intended to shield from additional regulation the institutional market for foreign currency that has existed among banks for many years and is not a blanket exemption for off-exchange futures contracts in particular types of enumerated commodities. Because that institutional market bears a resemblance to traditional futures contracts, the Treasury Amendment was necessary, but it did not authorize new products otherwise meant to be regulated by the CFTC. The Fourth Circuit erred in failing to make a factual inquiry whether the transactions in the present case properly fell within that traditional institutional foreign currency market,

or whether they represented new instruments which the CFTC must approve.

The Treasury Amendment was an expedient means to protect trading in existing markets from unnecessary additional regulation. The foreign currency market in question had undeniable elements of futures contracts, especially in light of the expansive new definition of commodity and the extended reach of the CEA after 1974. The adoption of the Treasury Amendment made it unnecessary to engage in an extensive analysis of the elements of futurity for these existing markets, as the legislative history clearly evidenced an intent to exempt them from the CEA. But as to novel contracts and schemes, it would frustrate the intent of the law to simply extend a blanket exemption to anything that might encompass foreign currency, as the Fourth Circuit has done. That is why it was necessary to engage in the factual inquiry into the marketplace and participants, which the Courts below failed to do.

The better approach was recently demonstrated in *CFTC v. Standard Forex, Inc.*, No. CV-93-0088 (Aug. 9, 1993), *appeal pending*, No. 93-6255 (2d Cir). The defendant in that CFTC injunctive action claimed that the foreign currency contracts being sold were excluded from CFTC jurisdiction by the Treasury Amendment. The Court explained that the ambiguity in the Treasury Amendment resulted from the difficulty in determining what transactions are not excluded because they "involve the sale thereof for future delivery conducted on a board of trade." *Id.*, slip opinion at 17. The Court then analyzed the legislative history of the Amendment, as is appropriate to resolve a statutory ambiguity, and found, following other opinions including

CFTC v. American Board of Trade and *Board of Trade v. SEC*, that the Treasury Amendment exclusion was limited to the interbank market for sophisticated financial institutions. *Id.*, at 22-23. The Court specifically declined to follow the District Court decision in the present case. *Id.*, at 24.

The *Standard Forex* contracts, like the Salomon Forex options, were sold by a private company and not traded on a recognized contract market. Using the same analysis as employed in *CFTC v. Co Petro supra,* the Court had no trouble finding Standard Forex to be an illegal "board of trade," given the purpose of the statute and its context in legislative history.

> [V]iewed in the context of the entire legislative history, the term "formally organized futures exchange" refers to situations in which people create a formal structure for unsophisticated investors who need the assistance of such a formal organization in order to carry out their trading, as opposed to sophisticates who can deal among themselves pursuant to relatively informal understandings. The Senate report follows the language of the letter submitted by the Treasury Department which instigated the adoption of the Treasury Amendment. . . . That letter referred to "organized exchanges" as including "individuals and small traders who may need to be protected by some form of governmental regulation," in order to contrast such trading contexts with sophisticated interbank transactions. . . Thus, the proper interpretation of the Committee's use of the letter's terminology is to view the use of the term "organized exchanges" as a reference to situations where private unsophisticated investors are transactional participants. *Id.*, at 25.

Is such the situation in the present case? One cannot tell, because the Courts below failed to make the proper analysis of the marketplace, its participants, and its use for speculation versus other commercial purposes.

Standard Forex demonstrates the necessity for Supreme Court review of this case. It is a case where bucket shop promoters seized upon the Treasury Amendment to claim the CFTC does not apply to them because they are "like" the Salomon Forex operations -- just as has been the case in past scams. A more reasoned approach to application of the CEA must be announced by this honorable Court.

CONCLUSION

For the reasons set forth above and those outlined in the brief of the Petitioner, NASAA joins Petitioner Tauber in urging the Court to grant the petition for writ of certiorari and hear the case on its full merits.

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No. 93-1314

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

LASZLO N. TAUBER, M.D.
Petitioner,
v.
SALOMON FOREX, INC., SALOMON INC., SALOMON BROTHERS, INC., AND FRED GATLING,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF OF THE BOARD OF TRADE OF THE CITY OF CHICAGO AND CHICAGO MERCANTILE EXCHANGE AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF THE BOARD OF TRADE OF THE CITY OF CHICAGO AND CHICAGO MERCANTILE EXCHANGE AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

STATEMENT OF THE *AMICI CURIAE*

The Board of Trade of the City of Chicago and the Chicago Mercantile Exchange provide markets where futures contracts and options on futures contracts are traded. The Board of Trade and CME support granting the petition for a writ of certiorari and urge this Court ultimately to overturn the court of appeals' decision. Both parties consent to the filing of this brief *amici curiae*.[1]

[1] The written consents have been submitted with this brief.

INTEREST OF THE *AMICI CURIAE*

"Derivatives are contracts whose value is derived—the key word—from the value of some underlying asset . . . ." Carol Loomis, *The Risk That Won't Go Away*, Fortune, March 7, 1994, at 40. The court of appeals' decision applies to two kinds of derivatives—futures and options —whose value derives from two kinds of assets: government securities and foreign currency.

Like other derivatives, futures and options fulfill a dual purpose; to allow businesses to manage price risks they face (for example, that currency values will fluctuate or interest rates will change) and to provide a means for speculators to assume the risks those businesses want to avoid. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 357-59 (1982). Futures and options are not generally traded by the retail public. Approximately 98% of all futures and options traded on the Board of Trade and CME are entered into by institutions or professional traders.

In 1993, the Board of Trade traded 178,773,105 futures and options contracts. Of that total, over 75% of all contracts traded involved government securities. The Board of Trade traded 102,863,608 Treasury Bond (30 Year) futures and options and 32,086,831 Treasury Note (10, 5 and 2 Year maturities) futures and options for a total of 134,950,439 contracts involving government securities.

The CME traded last year 146,746,990 futures and options contracts. Of that total, over 26% involved foreign currency.[2] In 1993, the CME traded 39,377,170 futures and options contracts involving Australian Dollars, British Pounds, Canadian Dollars, Deutsche Marks, French Francs, Japanese Yen and Swiss Francs.

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[2] The most heavily-traded CME futures and options markets involve Eurodollars, instruments that are not directly affected by the court of appeals' decision.

Each government security and foreign currency that is the subject of a futures contract is a "commodity" under the Commodity Exchange Act. 7 U.S.C. § 1a(3). The CEA regulates all trading in "commodity" futures contracts and options on those futures as well as options on certain "commodities," including currencies.[3] Subject to specific exceptions, the CEA requires all futures and options to be traded on "contract markets" that have been designated by the Commodity Futures Trading Commission. 7 U.S.C. §§ 6(a), 6c(b); 17 C.F.R. § 32.11.[4] The Board of Trade and CME have been designated by the CFTC as "contract markets." 7 U.S.C. §§ 7 and 8. The CEA's comprehensive regulatory scheme thus applies to the millions of government securities and currency futures and options contracts that are traded on the Board of Trade and CME.

The court of appeals' decision permits dealers operating outside a regulated exchange to escape the CEA by selling government securities and currency futures and options contracts for execution in the dealers' own back offices, rather than through the open and competitive facilities of a designated contract market. As a result, major Board of Trade and CME product lines now may be expropriated by off-exchange dealers and purveyed in an unregulated, less costly manner to the same institu-

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[3] The CFTC does not regulate options on "commodities" that are also securities, including government securities, and options on currencies traded on securities exchanges; those options are "securities" under the federal securities laws. 7 U.S.C. §§ 2a(i) and 6c(f); 15 U.S.C. §§ 77b(1) and 78c(a)(10). None of the transactions involved in this case is a security.

[4] In 1992, Congress enacted 7 U.S.C. § 6(c), which allows the CFTC to exempt futures contracts from the contract market designation and other statutory requirements "consistent with the public interest." CFTC rules already exempt "trade options" from the contract market designation requirement. 17 C.F.R. § 32.4. An option qualifies as a trade option when it is sold to a business and involves a commodity used by the business.

tions and professionals that now trade on the Board of Trade and CME. In that way, the court of appeals' decision threatens both to undermine the regulatory safeguards of the CEA and to inflict substantial competitive harm on the *amici*. In addition, the court of appeals' decision has created vast areas of statutory ambiguity which could undermine U.S. financial markets and cause market participants to shift their activities to overseas markets.

THE PROCEEDINGS BELOW

This case arose out of a trading dispute between the Petitioner, Dr. Laszlo Tauber, and the Respondents, a foreign currency dealer and related parties referred to collectively as "Salomon." Over a period of 2½ years, Salomon and Tauber entered into 2,702 currency transactions with each other. (2a)[5] At the end of that period, Salomon sued Tauber claiming he owed close to $26 million in unpaid losses. Tauber defended and counterclaimed by arguing, among other things, that the transactions at issue were unenforceable. Tauber asserted the contracts were futures and options that violated the CEA's mandate that all trading must be conducted on designated contract markets.

Salomon replied that the contracts were permissible under the CEA since they were forward contracts, not futures, and "trade options." Both kinds of instruments are not required to be traded on a designated contract market. 7 U.S.C. § 1a(11); 17 C.F.R. § 32.4. Salomon also argued that the contracts were excluded from the CEA under the Treasury Amendment since they were traded off-exchange.

That Amendment states:

> "Nothing in [the CEA] shall be deemed to govern or in any way be applicable to transactions in foreign

[5] Citations to the lower court opinions will be to pages in the Petition's Appendix.

> currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade."

7 U.S.C. § 2(ii). The Amendment thus excludes from the CEA any transaction that is found to be a "transaction in" one of the enumerated instruments, unless that transaction involves futures trading on a "board of trade." [6]

In granting summary judgment for Salomon, the district court ruled, solely on the basis of the Amendment, that the Tauber-Salomon transactions were not subject to the CEA. The district court

> 1) did not resolve the factual dispute over whether the transactions were futures or forwards or trade options, but presumed (without deciding) that the contracts were futures and non-trade options (30a n.4);
>
> 2) found that "[a]lthough the transactions in this case involved sales for future delivery, none was conducted on a board of trade" (35a); instead, "[t]hey were . . . conducted off-exchange" (30a); and
>
> 3) held that the "Amendment is unmistakably clear and unambiguous on its face. *All* transactions in which foreign currency is the actual subject matter of an off-exchange contract for future delivery are exempt from the CEA." (42a-43a) (Emphasis added.)[7]

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[6] The CEA defines "board of trade" to mean "any exchange or association, whether incorporated or unincorporated, of persons who are engaged in the business of buying or selling any commodity or receiving the same for sale on consignment." 7 U.S.C. § 1a(1).

[7] In the CEA, Congress defines futures contracts to be any "contract for the purchase or sale of a commodity for future

The court of appeals affirmed. It also treated the transactions at issue as futures and options (2a-3a; 19a) and found that the statutory "clause 'transactions in foreign currency' " included *"all* transactions in which foreign currency is the subject matter, including futures and options." (16a) While recognizing that the Amendment did not exclude transactions "conducted on a board of trade" (15a), the court of appeals claimed not to be deciding whether the Tauber-Salomon transactions were conducted on a "board of trade" (11a n.5). Later in its opinion, however, the court of appeals implicitly decided that the Salomon dealer market was not a "board of trade" by treating "organized exchange" as synonymous with "board of trade" and observing that the "statute commands . . . the exemption of all trading off organized exchanges." (20a) The court of appeals ultimately interpreted the Amendment to exclude "*all* off-exchange transactions in foreign currency, including futures and options, . . . from regulation by the CEA." (17a) (Emphasis added.) Thereafter, the court of appeals tried to temper that broad holding by asserting that the Amendment's exclusion applies to off-exchange currency futures and options "between sophisticated, large-scale foreign currency traders." (22a)

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delivery." 7 U.S.C. § 6(a). The district court used the term "future delivery" to emphasize that its holding would exclude futures contracts from the CEA.

ARGUMENT

THE FOURTH CIRCUIT'S DECISION CONFLICTS WITH OTHER CIRCUITS, DISRUPTS THE CEA'S STATUTORY SCHEME AND CREATES FINANCIAL MARKET CONFUSION.

The CEA provides a comprehensive regulatory scheme for futures and options trading. (5a) In addition to requiring all futures and options to be traded on designated contract markets, the CEA prohibits fraud and manipulation, requires market professionals to register, file reports and maintain books and records, and provides financial protections for market participants and their transactions. 7 U.S.C. §§ 6(a), 6b, 6c, 6d, 6e, 6f, 6g, 6i, 6k, 6m, 6o, 7, 8, and 9.

Certain CEA provisions also apply to cash and forward transactions. These are contracts where the parties actually contemplate performing their contractual obligations at the contracts' maturity—either through delivery of the commodity involved or payment of a cash equivalent.[8] In contrast, no more than 3% of all futures and options contracts result in delivery or performance at maturity. Instead, most futures and options are offset, a process

> "by which purchasers or sellers can liquidate their positions by forming opposite contracts. The price differential between the opposite contracts then determines the investor's profit or loss."

Commodity Futures Trading Comm'n v. Co Petro Mktg. Group, Inc. 680 F.2d 573, 579-580 (9th Cir. 1980). *See also Merrill Lynch*, 456 U.S. at 359 n.9. Cash and forward contracts are subject to various CEA provisions including reporting requirements, antimanipulation pro-

[8] For cash transactions, the contract's maturity is immediate—*e.g.* seller sells to buyer today. For forward transactions, the contract matures sometime in the future—*e.g.* seller sells to buyer for delivery in 90 days.

tections, and CFTC investigatory powers. 7 U.S.C. §§ 6i, 9, 12(d), 13(a)(2) and 20.

No one disputes that the Amendment excludes from the CEA cash and forward contracts in currencies and government securities. The issue the court of appeals faced was whether the Amendment also excludes currency and government security futures and options from the CEA's many regulatory mandates.

A. Multiple Circuit Conflicts.

Under the Amendment, the CEA does not apply to any transaction that meets both of two tests:

1) The transaction is a "transaction in" one of the enumerated instruments (currencies or government securities).

2) The transaction is not "conducted on a board of trade."

The Fourth Circuit misapplied each test and created multiple Circuit conflicts.

1. *"Transactions In."* The Fourth Circuit read the phrase "transactions in" to include futures and options contracts. (16a) The Second and Seventh Circuits disagree, as does every other court that has ruled on that phrase in the Amendment. *Commodity Futures Trading Comm'n v. The American Board of Trade, Inc.*, 803 F.2d 1242, 1248 (2d Cir. 1986) ("agree[s]" with the district court that "an option to buy or sell foreign currency is not a purchase or sale of the currency itself and hence is not a transaction 'in' that currency"); *Board of Trade v. Securities and Exchange Comm'n*, 677 F.2d 1137, 1146, 1154 (7th Cir.), *vacated as moot*, 459 U.S. 1026 (1982) (citations omitted) ("Nor are GNMA options 'transactions in government securities.' The option transaction is a long step removed from a transaction *in* the commodity involved . . .." "Congress understood the difference between 'transactions in' and 'transactions

involving.'"). *See also Abrams v. Oppenheimer Gov't Sec., Inc.*, 737 F.2d 582, 589-591 (7th Cir. 1984) (Amendment excluded GNMA forwards, not futures, from CEA); *CFTC and State of Georgia v. Sterling Capital Co.*, Comm. Fut. L. Rep. (CCH) [1980-82 Transfer Binder] ¶ 21,169 at 24,783-84 (N.D. Ga.), *modified by*, Comm. Fut. L. Rep. (CCH) [1980-82 Transfer Binder] ¶ 21,170 (N.D. Ga. 1981) (currency options are not "transactions 'in' foreign currency" under the Amendment); *Bank Brussels Lambert, S.A. v. Intermetals Corp.*, 779 F. Supp. 741, 748-50 (S.D.N.Y. 1991) (Amendment excluded cash currency transactions, not futures).

The Second and Seventh Circuit's conclusion that cash and forward contracts are "transactions in," but futures and options are not, turned on a natural and logical reading of that phrase. In any cash or forward transaction, the seller contemplates actually delivering, for example, currency or government securities to the buyer at an agreed to price. Those parties have entered into literally a transaction in the commodity. Most futures or options do not result in delivery; they are trading instruments that reflect the market participants' perceptions of the future value of an underlying commodity—whether it be currency, government securities or soybeans. As such, futures and options "[t]rading occurs in 'the contract,' not in the commodity." *Chicago Mercantile Exchange v. SEC*, 883 F.2d 537, 542 (7th Cir. 1989), *cert. denied*, 496 U.S. 936 (1990).[9]

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[9] When Congress refers to futures in the CEA it uses the term "future delivery." *See e.g.*, 7 U.S.C. § 1a(3) ("contracts for future delivery"); § 2(i) ("contracts of sale of a commodity for future delivery"); § 5 ("[t]ransactions in commodities involving the sale thereof for future delivery"); § 6(a) ("contract for the purchase or sale of a commodity for future delivery"); and § 6b (treats separately "any contracts of sale of any commodity" and "any contract of sale of any commodity for future delivery"). Congress did not refer to "future delivery" in the Amendment's

Under the Second and Seventh Circuit's view, the Amendment excludes cash forward transactions in currencies and government securities from the otherwise applicable CEA provisions dealing with manipulation, reporting and CFTC investigations. The Fourth Circuit disagreed, claiming the Amendment would be superfluous if applicable only to cash forward transactions since the CEA already completely excluded those transactions from regulation. (6a; 16a) That view overlooks those CEA requirements that do apply to cash forward transactions. *See supra* 7-8.

The Fourth Circuit attempted to reconcile its decision with those of the Second and Seventh Circuits by claiming that those decisions turned on *who* could enter into the transactions and *where* the transactions occurred, *i.e.* "on-exchange" transactions as opposed to "off-exchange." (20a-22a) The Amendment, however, never refers to the identity of the parties that could enter into excluded contracts. The Amendment's second test does address where an excluded transaction could occur—the transaction may not be "conducted on a board of trade." That second test applies to only transactions that meet the first test, the "transactions in" test. The Second and Seventh Circuits simply held that options and futures did not meet that test as "transactions in." [10]

"transactions in" clause, an omission the court of appeals ignored. Congress also generally described options when it wanted a provision to apply to options. 7 U.S.C. §§ 1a(5)(A)(II), 2(i), 5, and 6c(b). The Treasury Amendment never mentions options.

[10] The court of appeals read the "transactions in" test to be dependent on the "board of trade" test and found that the second test would have no meaning unless "transactions in" included futures and options. (15a) That argument ignores the fact that most futures contracts traded on a board of trade and held to maturity result in an obligation to make or take delivery of a commodity. That delivery process constitutes a transaction "in" the commodity. The Amendment brings back into the CEA those "transactions in" currency or government securities which "involve" futures

2. *"Board of Trade."* If the Fourth Circuit correctly extended "transactions in" to futures and options, then those transactions are excluded from the CEA "unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii). The court of appeals therefore had to decide whether the Tauber-Salomon futures and options contracts were "conducted on a board of trade." *See Board of Trade*, 677 F.2d at 1154 (if GNMA options are covered by "transactions in" then "the 'unless' clause would apply.").

The court of appeals either missed that required step or interpreted the term "board of trade" in a way that conflicts with the Ninth Circuit's decision in *Co Petro.* Unlike the district court, the court of appeals asserted it was withholding judgment on whether the Tauber-Salomon transactions were conducted on a board of trade (although it was "inclined" to say they were not). (11a n.5) Nevertheless, the court of appeals seemingly joined the district court in equating the term "exchange" with "board of trade." (22a; 30a; 35a). The Fourth Circuit concluded: the Amendment "distinguishes only between on-exchange and off-exchange trading." (20a)

No it doesn't. The Amendment distinguishes transactions "conducted on a board of trade" from off-board of trade transactions. The CEA does not equate a board of trade with an exchange. Rather, "board of trade" means "any exchange *or* association . . . of persons who are engaged in the business of buying or selling any commodity . . .." 7 U.S.C. § 1a(1) (Emphasis added).

The Ninth Circuit has rejected the very position the Fourth Circuit adopted—that off-exchange transactions necessarily are conducted "off-board of trade." *Co Petro*, 680 F.2d at 581-582. The Ninth Circuit held "the statutory definition of 'board of trade' . . . is broad enough to encompass" an off-exchange dealer in petroleum fu-

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trading on a board of trade because they are part of the futures delivery process. *Board of Trade*, 677 F.2d at 1154 and n.33.

tures, whose activities paralleled those of Salomon here. *Id.* at 581. Indeed, in contrast to the Fourth Circuit's attempt to erase from the statutory "board of trade" definition everything after the word "exchange," the Ninth Circuit concluded (*id.*):

> "Where Congress has, as here, intentionally and unambiguously drafted a particularly broad definition, it is not our function to undermine that effort."

3. *Ramifications of the Conflicts.* After the Fourth Circuit's decision, the CEA's coverage would be determined by geography. In the Second and Seventh Circuits (and maybe the Ninth Circuit due to *Co Petro's* "board of trade" holding), the CEA applies to all government securities and currency futures and options, except those options Congress expressly delegated to the SEC. *See supra,* at 3 n.3. In the Fourth Circuit, the CEA now does not cover all futures and options; by the simple expedient of off-exchange trading, the CEA's provisions may be avoided.

Financial markets are not as easily segregated as appellate circuits. The conflicts created by the Fourth Circuit therefore promote great uncertainty that will likely trouble all financial market participants. What would happen, for example, if a manufacturer in New York doing business overseas and a Chicago-based importer try to hedge their respective currency risks by entering into currency futures contracts with each other through a broker in Baltimore? Does the CEA apply to that transaction? Could either the New York manufacturer or Chicago importer invoke the CEA in an attempt to walk away from losses under the contract? Or would the party looking for payment on the contract prevail because the broker's situs within the Fourth Circuit excludes the instrument from the CEA?

Even without claims of illegality, the Circuit conflicts create irrational discrepancies. It makes no sense that futures and options traded off-exchange in New York

City or Chicago would be subject to the CEA, but the same activity would be outside the CEA if conducted in Baltimore. Congress enacted a federal regulatory scheme under the CEA to prevent such bizarre forum-determinative results. Thus, the Circuit conflicts presented here merit resolution by this Court.

B. The Decision Raises Important Federal Questions.

Even if no conflict existed, the Fourth Circuit's decision alone presents important federal questions warranting review. The court of appeals' decision eliminates statutory cornerstones, imposes a severe competitive handicap on the Board of Trade and CME and breeds uncertainty among market participants.

1. *Threat to the CEA and the Amici.* Under the Fourth Circuit's decision, off-exchange dealers may copy some of the most popular futures and options contracts traded on the Board of Trade and CME today, market those instruments to the same "sophisticated traders" that comprise 98% of the trading on the Board of Trade and CME and escape the CEA and all other regulatory costs. The decision creates a vast hole in the CEA and a competitive nightmare for the Board of Trade and CME.

One example illustrates the scope of the interests at stake. Assume a subsidiary of a Baltimore investment bank decided to make a market as a dealer in Swiss Franc futures (just like the contracts traded at the CME). According to the court of appeals, the off-exchange dealer and its futures transactions would be excluded from the CEA. The dealer and its contracts also would not be subject to any other scheme of market regulation.[11] If the dealer decided to operate markets in

[11] The dealer would not be subject to SEC jurisdiction because Swiss Franc futures, like all other futures and many options, do not fit within the definition of a security. After the Seventh Circuit ruled in *Board of Trade v. SEC* that virtually no derivatives were securities, Congress amended the definition of security to

any Treasury securities or other currency futures and options now being traded on the Board of Trade and CME, those transactions also would not be subject to the CEA or any other market regulation. Thus, the dealer could duplicate the major product lines of the Board of Trade and CME, sell those products to the Board of Trade's and CME's predominant client base and completely avoid the CEA and federal regulation.[12]

Putting aside the unfair competitive implications of that result, leaving off-exchange dealer markets in futures and options unregulated while exchange markets in the same type of instruments are heavily-regulated would only make sense if dealer markets were much less risky than exchanges. Just the opposite is true. As the CFTC has explained, exchange

> "markets provide safeguards to participants in futures and commodity option transactions, including open competitive trading, public price dissemination, and protection against counterparty credit risk, that are not generally available other than on exchange markets. . . . As a consequence, . . . [off-exchange] instruments . . . may be exchanged without the benefit of protections afforded participants in transactions effected on or pursuant to the rules of Commission designated exchange markets, including safeguards

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include only certain specified options. 7 U.S.C. §§ 2a(i) and 6c(f); 15 U.S.C. §§ 77b(1) and 78c(a)(10).

[12] An investment bank's dealer subsidiary would not be subject to any regulation, including federal banking regulation. In contrast, any commercial bank subsidiary or affiliate that tries to operate as a dealer in government securities or currency futures and options would face some form of "safety and soundness" regulation by bank regulators. But even bank regulation is not a substitute for the CEA's market regulation. For example, bank regulators would have no direct jurisdiction over a bank's customer that perpetrates a fraudulent or manipulative scheme on other participants in the bank's dealer market.

against counterparty default and other transaction risks."

52 Fed. Reg. 47022 (1987). *See also* J.R. Laing, *The Next Meltdown?*, Barron's, June 7, 1993, at 10 (Salomon Chairman Warren Buffet "opines" exchanges have less risk than "bi-lateral, over-the-counter derivatives trading").

Congress agrees with that view. For 70 years, Congress and the CFTC permitted and regulated trading in futures on designated contract markets and banned non-contract market trading in futures. 7 U.S.C. § 6(a). Just recently, in 1992, Congress allowed that ban to be lifted, but only if the CFTC made certain specific "consistent with the public interest" statutory findings. 7 U.S.C. § 6(c)(2). Despite that congressional history, the Fourth Circuit construed the Amendment as if, in 1974, Congress intended to make superfluous the CEA's linchpin—the contract market designation requirement—for currency and government security futures and options. Statutory exemptions, however, should be narrowly construed. *A.H. Phillips, Inc. v. Walling*, 324 U.S. 490, 493 (1945) ("Any exemption . . . must . . . be narrowly construed"); *Commissioner of Internal Revenue v. Clark*, 489 U.S. 726, 739 (1989) ("In construing provisions such as [the tax code] in which a general statement of policy is qualified by an exception, we usually read the exception narrowly in order to preserve the primary operation of the provision."). When, as here, a court of appeals decision adopts an overbroad reading of a statutory exclusion that nullifies central requirements of a federal regulatory scheme, that decision presents a significant issue for this Court's review.

2. *Market Confusion and Uncertainty.* The Fourth Circuit's decision also would create financial market confusion. As is often the case when courts try to redraw legislative policy lines, the court of appeals' decision involves imprecise and undefined terminology such as "in-

dividually-negotiated" and "sophisticated, large-scale foreign currency traders." (22a) Even assuming that "individually negotiated" is code for "off-exchange," [13] the possible interpretive issues created by a "large trader" standard will promote great uncertainty. What does "sophisticated" or "large-scale" mean? Is a failing savings & loan eligible? Should an insurance company, credit union, export manufacturer, commodity pool or pension fund of any size qualify? No one really knows.

An additional factor causing market uncertainty is that no one knows which part of the Fourth Circuit's opinion to follow. Is it the "statute commands" that "all trading off organized exchanges" in currencies and government securities futures and options is excluded from the CEA? (20a) That reading would allow bucket shops and boiler rooms to sell futures and options to the retail public, the most notorious evil the CEA's contract market designation requirement is designed to prevent. Or is it the decision's later attempt to rewrite and contradict that "statutory command" by allowing only "large traders" (22a) to trade unregulated off-exchange futures and options?

That confusion might be ameliorated somewhat if the government historically had adopted consistent views on the Amendment's meaning. But the government has offered disparate views on the Amendment's scope over the past two decades. Petition for Writ of Certiorari at 17-20. Even today, the Treasury Department and the CFTC would likely bicker over which branch of the Fourth Circuit's decision—the "statutory command" or "large traders only"—to follow. Indeed, they took opposite positions on that issue in their separate *amicus* briefs in the Fourth Circuit in this case.

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[13] The Board of Trade now trades Flex Options which allow traders to customize through individual negotiation various options transactions involving government securities futures. Since exchanges now trade customized instruments, the line the court of appeals tried to draw is even more blurry.

The CFTC has even disagreed with itself over time. In 1975, the CFTC concluded that under the Amendment

> "the CFTC would not have any jurisdiction with respect to the purchase and sale of the enumerated financial instruments themselves (the 'cash market'), but would have jurisdiction solely with respect to futures trading in those instruments."

SEC-CFTC Jurisdictional Correspondence, Comm. Fut. L. Rep. (CCH) [1975-77 Transfer Binder] ¶ 20,117 at 20834 (Dec. 3, 1975). The CFTC analyzed the Amendment's 1974 legislative history and concluded the Amendment was enacted to remove the "Treasury's fear of CFTC cash market jurisdiction" over the enumerated instruments. *Id.* at 20834 n.13.

By 1992, the CFTC had adopted a far different reading of the 1974 legislative history. Based on that same history, the CFTC told the Fourth Circuit the Amendment was intended to exclude all off-exchange currency and government securities futures "between sophisticated and informed institutions that ordinarily trade in the enumerated financial instruments." Brief *Amicus Curiae* of the Commodity Futures Trading Commission at 10, *Salomon Forex, Inc. v. Tauber*, 8 F.3d 966 (4th Cir. 1993) (No. 92-1406). Under that reading, Congress wanted any trading covered by the Amendment to be excused from CEA regulation even if, as here, no other regulatory scheme applied.

The CFTC's 1992 position violates a cardinal principle of the 1974 CEA amendments, legislation that included the Amendment. In 1974, the Chairmen of the House-Senate Conference Committee both underscored:

> "It was the intent of the committees to fill all regulatory gaps—to regulate trading in futures and in options relating to commodities or commodity futures, because such trading is now poorly regulated, if it is regulated at all."

120 *Cong. Rec.* 34736 (Oct. 9, 1974) (Remarks of Rep. Robert Poage); 120 *Cong. Rec.* 34997 (Oct. 10,

1974) (Remarks of Senator Herman Talmadge). For that reason, courts have uniformly found the 1974 amendments to be designed to plug all regulatory gaps.[14] The CFTC's new position, as adopted by the Fourth Circuit, contravenes that vital and explicit congressional policy by establishing a regulatory void for futures and options traded off-exchange. By advancing a new construction of the Amendment without addressing the "regulatory gap" it would foster, the CFTC's 1992 view further exacerbates the legal confusion under the Amendment.

The Amendment has sparked widespread confusion. After the Fourth Circuit's decision, the CFTC itself acknowledged the uncertain state of the law. CFTC, *The Report of the CFTC: OTC Derivative Markets and Their Regulation*, at 155-56 (October 1993). Only three months ago, the Chairman of the American Bar Association's Committee on Futures Regulation characterized the "scope of the Treasury Amendment" after the Fourth Circuit's decision as "unsettled." S. Selig, Chair, *Report of the ABA Committee on Futures Regulation*, at 4 (Dec. 20, 1993).

Financial market participants are leery of such uncertainty. If foreign markets offer more legal certainty, futures and options business now conducted in the U.S. could easily be transported overseas through modern communications and other technologies. By reviewing this decision and resolving the conflicts and ambiguities now plaguing the important coverage issues the Amend-

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[14] *See Board of Trade*, 677 F.2d at 1159 ("Congress believed it was filling a regulatory void . . ."); *Point Landing v. Omni Capital Int'l, Ltd.*, 795 F.2d 415, 420 (5th Cir. 1986) ("Congress intended the 1974 amendments to 'fill all regulatory gaps' while 'avoid[ing] unnecessary, overlapping and duplicative regulation' ") (citation omitted); *Gonzalez v. Paine, Webber, Jackson & Curtis, Inc.*, Fed. Sec. L. Rep. (CCH) [1982 Transfer Binder] ¶ 98,867 at 94,514 (S.D.N.Y. 1982) (1974 amendments " 'filled the protective regulatory gap' " once occupied by pre-1974 decisions finding federal securities laws applicable to commodity futures accounts) (citation omitted).

ment has generated, this Court would serve the short and long term needs of U.S. financial markets and their participants for legal certainty and sensible federal regulatory lines.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

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No. 93-1314

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

LASZLO N. TAUBER, M.D.,
Petitioner,

v.

SALOMON FOREX, INC., SALOMON INC.,
SALOMON BROTHERS, INC., and FRED GATLING,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

The Fourth Circuit's decision is of unquestionable importance to very large markets, and there is a sharp split in the circuits, and among government agencies, over the proper meaning of the Treasury Amendment and, therefore, over what activities are permissible in those markets. Nothing in Salomon's brief in opposition undermines those fundamental reasons for granting certiorari in this case. Because Salomon makes no serious effort to defend the Fourth Circuit's opinion on its merits, we focus here on the reasons for review aside from the erroneousness of the Fourth Circuit's decision.[1]

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[1] It is worth noting at the outset that, contrary to Salomon's intimations, Tauber has testified that he had no idea at the time of the transactions at issue here that they were illegal off-exchange trades (Tauber Dep. Tr. 308), and there is no support whatever for

1. Nothing in Salomon's discussion of the sheer impact of the Fourth Circuit's decision (Br. in Opp. 10-13) undermines the petition's showing that the decision permits exemption from the entire CEA regulatory scheme of what may be half of all the futures and options currently traded on regulated exchanges—a showing confirmed by the *amicus* brief of the Chicago Board of Trade and Chicago Mercantile Exchange. The Fourth Circuit's actual announced interpretation of the Treasury Amendment, holding that *all* foreign currency and government securities futures and options may freely be moved off the regulated exchanges and hence outside the CEA (Pet. App. 17a), applies to tens, perhaps hundreds, of millions of contracts annually. *See* Pet. 20-21; CBOT & CME *Amicus* Br. 2-3. And even under the limitation to "sophisticated, large-scale" traders that the Fourth Circuit tacked on to its opinion at the end, the impact is virtually indistinguishable, because "approximately 98% of all futures and options traded on the Board of Trade and CME are entered into by institutions or professional traders." CBOT & CME *Amicus* Br. 2; *id.* at 13.

Beyond that, Salomon can hardly claim that the Fourth Circuit's notion of "sophisticated, large-scale" traders actually limits the importance of the decision. For one thing, the Fourth Circuit did *not* hold that other traders are outside the Treasury Amendment and hence still covered by the CEA; it merely declared that its present holding, in this case, reached no further than "sophisticated, large-scale" traders, purporting to leave the question of the Treasury Amendment's application to other

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the suggestion that Tauber entered into any such transactions after learning of the legal constraints when this litigation commenced. Moreover, it is undisputed by Salomon that, if the 68 futures contracts are illegal, Salomon is not entitled to come to court and obtain enforcement of them. It is equally undisputed that Congress has established a remedy providing strict deterrence of illegal options transactions, entitling any party suffering losses to recover damages. 7 U.S.C. § 25.

types of traders for another day. Pet. App. 22a. And Salomon could not honestly suggest a different answer to that question. After all, the Fourth Circuit gave no reason whatever tying its declared limitation to the text or analysis of the Treasury Amendment (Pet. App. 22a); and when the court did analyze the Amendment, it explicitly came to the conclusion that "all off-exchange transactions in foreign currency, including futures and options, are exempted from regulation by the CEA" (Pet. App. 17a). Indeed, it is Salomon's own view that the Fourth Circuit *could* not support its purported limit on its current judgment, since adopting that limit as a holding would be a mistake: the Treasury Amendment applies "without regard to the identity of the participants." Salomon C.A. Br. 23. *See* Pet. App. 13a.

In short, whether one accepts or discounts the Fourth Circuit's artificially appended and unjustified attempt to avoid the consequences of its express interpretation of the Treasury Amendment, including the intercircuit conflict, the ruling is of undeniable importance. Salomon's claim that the issue presented here is "narrow and factbound" (Br. in Opp. 10)—in the face of submissions by numerous government and private *amici* in this Court and in the Fourth Circuit—is groundless.

2. Salomon's brief is equally unpersuasive in trying to explain away the patent conflict among judicial (and government) interpretations of the Treasury Amendment. *See* Br. in Opp. 14-17. The Second and Seventh Circuits both have squarely *held* that the purchase and sale of options (as sued upon here, under 7 U.S.C. § 25) are outside the Treasury Amendment because they are not "transactions in [a commodity]"; and both have adopted, as their rationale, the construction of the phrase we urge —as referring only to an actual purchase and sale of the commodity (thus, as the Seventh Circuit observed, excluding futures as well as options). *See* Pet. 14-15. Under that interpretation, if what is sold is a future (not

a "forward") or an option (other than a "trade option"), then the Treasury Amendment simply does not apply, and that is so wholly irrespective of whether the parties are "sophisticated" or "large-scale" traders. By contrast, in the Fourth Circuit, "all" off-exchange futures and options involving foreign currency or government securities come within the Treasury Amendment's exclusion from the CEA (Pet. App. 17a) or at least those bought and sold off-exchange by "sophisticated, large-scale" traders (Pet. App. 22a).

These plain conflicts in constructions and holdings are matched by conflicts, and internal inconsistencies, in the interpretations offered by various government agencies, including the CFTC.[2] The resulting uncertainty about governing law—compounded by the lack of clarity even in the Fourth Circuit's own notions of "sophisticated" or "large-scale"—is intolerable, affecting as it does

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[2] Notwithstanding its remarkable heading "There Is Unanimity in Government Views," Salomon acknowledges the wide divergence of interpretations of the Treasury Amendment proffered by various agencies of the federal government, including in separate briefs in this very case. Br. in Opp. 14-15. Salomon makes several false or misleading claims in trying to avoid that fact. First, Salomon is wrong in twice asserting (*id.* at 9, 14) that the CFTC in this case urged the Fourth Circuit to affirm the district court judgment: the CFTC brief conspicuously avoids any such assertion with respect to the futures contracts that Salomon seeks to enforce. Second, with respect to options (*see id.* at 14 n.17), the CFTC's only stated view on the Fourth Circuit's position on options *disagrees* with that position and instead agrees with our view (and that of the Second and Seventh Circuits) that the off-exchange sale of options is illegal. *See* Pet. 17-18. (The CFTC's argument in the Fourth Circuit regarding options, which was correctly disregarded by the court, has nothing to do with the legality of the *sale* of options, the issue here under 7 U.S.C. § 25.) Third, the 1975 CFTC Staff interpretation's "acknowledgment that the Treasury Amendment applies to off-exchange contracts" (Br. in Opp. 15) refers, of course, to spot and forward contracts, *not* futures or options; the interpretation expressly adopts precisely our view of the Treasury Amendment. *See* Pet. 5 n.4.

a very large volume of futures and options transactions. *See* Pet. 13 n.10 (CFTC noting need for correcting current confusion); *see also* CBOT & CME Br. 18 (ABA committee chairman noting "unsettled" state of law after Fourth Circuit decision). Resolution of such uncertainty is the classic function of this Court in statutory cases.

3. Salomon's principal effort to downplay the circuit conflict, and to diminish the importance of the Fourth Circuit's decision, is its pervasive reliance on a contrast between "privately-negotiated, off-exchange transactions among professional[s]" and "trading of standardized contracts conducted on or over an exchange." Br. in Opp. 16. There are several reasons why this distinction neither dissolves the circuit conflict nor discounts the decision's impact. It therefore offers no reason whatever for denying the petition.[3]

Thus, the factors relied upon by Salomon are in no way relevant under, or mentioned by, either the Second or the Seventh Circuit opinions in explaining their adoption of their construction of the Treasury Amendment, under which transactions in futures (not forwards) and options are specifically distinguished from "transactions in [the specified commodities]." Moreover, as already noted,

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[3] We note that Salomon's other grounds for dealing with the Seventh Circuit decision, aside from being inapplicable to the Second Circuit decision, fare no better. Br. in Opp. 16-17 (discussing *Board of Trade v. SEC*, 677 F.2d 1137, *vacated as moot*, 459 U.S. 1026 (1982)). The Seventh Circuit decision, while vacated for mootness, continues to be authoritative in both the Seventh Circuit and elsewhere, as the CFTC has observed. *See* Pet. 15 n.11. The Seventh Circuit *did* explicitly rule on the Treasury Amendment (677 F.2d at 1154), in addition to another CEA provision; and its ruling as to government securities fully applies to foreign currency, because both are commodities listed in the Amendment. And the subsequent Seventh Circuit decision in *Abrams v. Oppenheimer Gov't Securities*, 737 F.2d 582 (7th Cir. 1984), written by the same judge as *Board of Trade*, expressly involved "forwards," which are legally distinct from "futures" under the CEA (*see* Pet. 5-6) and which *Abrams* expressly distinguished from futures. 737 F.2d at 585-87, 590.

the Fourth Circuit itself offered no explanation tying these factors to the *Treasury Amendment*; and Salomon, for its part, not only fails to offer any such explanation but has affirmatively argued that the factors are wholly irrelevant to the Treasury Amendment. *See* page 3, *supra*. Decisions cannot be legitimately distinguished on the basis of a *mistaken* reading of the statute.

What Salomon is doing, in fact, is trying to change the issue without openly saying so. The issue to which the identified factors *have* been argued to be relevant (incorrectly, *see* Pet. 5 n.5) is the question whether particular contracts are "forwards" or "futures"—but that issue has nothing whatever to do with options, is irrelevant to the validity of the Fourth Circuit's ruling that *futures* are within the Amendment (*e.g.*, Pet. App. 2a, 13a, 17a, 19a, 22a), and is open for litigation if the summary judgment for Salomon is reversed.[4] It is also worth noting why the suggested distinction cannot be the basis for determining application of the CEA: after all, even on-exchange instruments may be individually negotiated (*see The Lookalike Competition*, 7 Risk 20 (March 1994)); the CEA has always covered "professionals" as well as the "public"; and whether a transaction is subject to the CEA's fundamental requirement of on-exchange trading (7 U.S.C. §§ 6, 6c) cannot logically depend on whether the transaction is conducted on-exchange. *See In re Bybee*, 945 F.2d 310, 313 (9th Cir. 1991).[5]

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[4] The district court specifically held that a trial would likely be required in order for Salomon to try to establish that the contracts at issue were "forwards" or "trade options." Pet. App. 30a n.4, 32a n.8.

[5] Salomon makes a brief and wholly novel reference to a CFTC rule on "swap agreements." Br. in Opp. 11 n.13. But the Fourth Circuit decision is a holding about the Treasury Amendment, which excludes certain transactions from the CEA in its entirety; the swap rule, even where it applies, leaves transactions subject to various provisions of the CEA and CFTC jurisdiction. 58 Fed. Reg. 5587 (1993). Notably, Salomon never suggested to the Fourth Circuit that this rule was a basis for prevailing, even

In sum, in addition to being incorrect,[6] the Fourth Circuit decision should be reviewed because the proper interpretation of the Treasury Amendment is a matter of patent importance on which there is obvious disagreement and uncertainty, and Salomon's ground for treating the case as insignificant, which Salomon itself deems immaterial under the provision, is meritless.

CONCLUSION

The petition for a writ of certiorari should be granted.

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though the rule appeared before Salomon even filed its last brief, months before the oral argument and decision in this case. That omission is hardly surprising given that the transactions at issue here, *unlike* other transactions Salomon entered into with Tauber, were not called "swaps" by the parties; the rule does not purport to resolve the Treasury Amendment issue; and the CFTC, in its October 1993 Report to Congress on this very case, made no reference to the swap rule. It is also peculiar to suggest that a transaction removed from the CEA by the Treasury Amendment can be subject to CFTC authority applicable only to transactions covered by the CEA.

[6] It is worth noting one important error in Salomon's discussion of the legislative history of the Treasury Amendment. Br. in Opp. 19. Although Salomon claims that "petitioner is simply wrong in asserting that congressional committees avoided 'any reference to futures' in their comments on the Treasury Department's proposed amendment" (*ibid.*), all that Salomon is referring to is, naturally enough, the committee's description of *what the Treasury Department said in its letter*. The committee said not one word about futures, much less options, in its *own* description of the legislation or of what *it* understood the law to do.